



ICAS comments

Draft legislation:

The VAT (Amendment) Regulations 2018 and
related documents published on 18 December 2017

9 February 2018

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants; 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.

Overview

3. ICAS welcomes the opportunity to comment on: 'Draft legislation: the VAT (Amendment) Regulations 2018' and the related documents published on 18 December 2017.
4. We remain of the view that the timetable for the introduction of mandatory Making Tax Digital for VAT is unrealistic. Mandatory implementation should be deferred until 2020 at the earliest – preferably later.
5. The announcement of the new timetable for MTD included a promise (for VAT) of “well over a year of testing” before any businesses would be mandated to use the system. It is clear that this cannot be delivered. The pilot is expected to commence in April 2018 but with only a small number of single proprietor simple businesses allowed to join at that point. Any larger or more complex businesses (and any repayment traders) will get nothing like 12 months of testing, meaning that many problems risk not being identified, let alone fixed, before mandatory implementation.
6. The timing of mandatory implementation coincides with Brexit. Businesses affected by Brexit are currently prioritising time and resources for contingency planning and preparation for a no-deal outcome. Inevitably, MTD is taking second place. Even if there is some form of Brexit deal there are still likely to be major changes to VAT and Customs Duties in 2019. It is unreasonable to expect businesses to deal with MTD at the same time as Brexit, particularly when the promised 12-month testing period will not be available for most businesses, particularly larger and more complex ones.
7. The timing is also likely to present significant problems for HMRC. The Public Accounts Committee, in its recent report on HMRC, identified that HMRC is under considerable pressure. It is undertaking 15 major transformation programmes and with the additional pressures arising from Brexit it is having to consider how to change its priorities.
8. Mandatory implementation should not be considered before the system has been demonstrated to work properly for all businesses. MTD for VAT should be available on a voluntary basis, alongside voluntary MTD for business income tax, for a long enough period to allow for a wide range of software products to be made available and for adequate testing to take place with all types of business to identify and fix problems.
9. The requirement to adopt MTD should be linked to the beginning of the next business financial accounting year rather than to the start of the next VAT period. This is discussed in more detail below.
10. We welcome the inclusion of the two soft-landing scenarios in the addendum. It is useful that these problems have been acknowledged. However, we do not believe the soft-landing approach currently goes far enough; we make some detailed suggestions for extending it below. We also believe that the soft-landings should be included in the regulations (or in part of the VAT notice which has the force of law) so that businesses are not put in the position of relying on a concession from HMRC to avoid penalties.

11. We do not believe it is right to force businesses to use third party software to meet their basic tax obligations, when there are unresolved concerns about whether HMRC will be able to enforce:
- minimum standards for functionality;
 - the ongoing availability of software, once adopted;
 - provision of assistive or other non-standard software;
 - adequate security; or
 - other features important to users.

Based on discussions at meetings with HMRC, we do not believe there is even a mechanism for enforcing the limited requirements in the terms of collaboration.

Pilot and timetable

12. The current timetable is too compressed to allow realistic testing over an adequate period with all types of businesses. No software products are currently available, so businesses cannot even start their preparations.
13. We understand from HMRC that 60 third party software developers are working to develop products so that by April 2018 (the start of the pilot) there could be 100 products available. Equally, as HMRC has no control over commercial developers, there could be a much smaller number.
14. The pilot will start with simple, single proprietor businesses. This means that all large businesses and any businesses with more complex VAT affairs will not be able to join at the outset. This means that only the smallest, simplest businesses will have anything like the promised one-year testing period to ensure the software works. Even for these businesses there may not be enough time to address any issues arising from the pilot.
15. Depending on when (or if) larger/more complex businesses are allowed to join the pilot there will be little or no time to identify and correct any problems arising for these businesses before mandatory adoption.
16. We have been told by HMRC that repayment traders will not be allowed to join the pilot at the outset 'in case something goes wrong', as these businesses would be badly affected by any problems. However, given that it is very important that the system works for these businesses, leaving them until later in the pilot again means that there may be insufficient time to fix any issues prior to mandatory implementation.
17. It is imperative that there should be full testing for annual adjustment/capital goods scheme. However, the scheduled go-live of 1 April 2019, does not allow for a full year of returns to be filed (say June-18, September-18, December-18 and March-19) and then an annual adjustment to be prepared and filed (say June-19, by which point the system will be live). This illustrates the importance of honouring the promise of "well over a year of testing" before mandatory implementation.
18. There is no guarantee that software will be available for all businesses in time for them to prepare adequately – or even for some businesses by April 2019 when MTD filing becomes mandatory. Commercial developers are likely to target sectors of the market where they believe demand will be highest. This could leave charities, individuals requiring assistive software and others with non-mainstream requirements, without software – or paying a very high price for a product which may or may not meet their requirements. Those with non-standard needs are also less likely to be able to take part in the pilot – or may only be able to join too late for problems to be resolved in time.
19. This illustrates the unsatisfactory nature of an approach which depends on commercial software providers – combined with a timetable which does not allow time for proper testing of the software and could leave some users without software which meets their requirements. As noted above we believe that MTD for VAT should be introduced on a voluntary basis and that mandatory implementation should only be considered once it is clear that it will work for all businesses.

Exemptions

20. If mandatory implementation goes ahead at April 2019, then in view of the problems outlined above, we believe that the provisions in the regulations for exemption from the electronic requirements should make explicit that in 32B 1(c) 'any other reason' should include the non-availability of software which meets the requirements of the business.

Interaction with MTDfB

21. It is disappointing that the issues we raised in our previous submission (on the VAT legislation overview) around the interaction between MTD for VAT and MTD for business income tax (which could be introduced in 2020) have not been addressed.
22. The January 2017 MTD consultation response envisaged that the deadline for submissions of information for VAT and income tax would be aligned. However, this will not happen prior to mandatory implementation of MTD for VAT. There will also be a lack of alignment between certain elements of the VAT and income tax rules, for example, cash basis.
23. Some businesses will want to use the same MTD software for income tax and VAT and will want to align payment dates etc. However, HMRC have said that the issues relating to interaction between the two will not be considered until a decision is taken on mandatory implementation for income tax (and potentially CT).
24. There is therefore no guarantee that software developers will produce packages which allow for future alignment. Businesses could find that they have chosen a software provider for VAT which does not produce a product which meets their needs for income tax in 2020. They will therefore be forced either to use different software packages for income tax and VAT, or to switch to another provider. Either option is likely to increase costs and cause more disruption. This undermines one of the business benefits HMRC originally stated would arise from MTD - bringing all tax together in one place.

Entry into MTD

25. The draft amendment regulations currently provide that they will have effect from 1 April 2019 where a taxpayer has a prescribed accounting period which begins on that date and otherwise from the first day of a taxpayer's prescribed accounting period beginning after 1 April 2019.
26. This means that the large number of businesses on stagger 1 will need to move into MTD at 1 April 2019. Moving all these businesses at the same time is likely to be challenging for agents, businesses and HMRC.
27. Implementation is also likely to present significant issues for some businesses seeking to obtain suitable software and wanting to switch to the new software at the beginning of their financial year, rather than part way through it. A business with a financial year to 30 June would want to put in place new software at 1 July 2018. Very little software is likely to be available, so the business may be unable to find anything suitable. As noted above we believe that MTD for VAT should be introduced on a voluntary basis over a longer period. If that approach is not adopted we suggest that the mandatory implementation date should be changed, so that it relates to the beginning of the next financial year of the business rather than the beginning of the next VAT period.
28. Tying the requirement to adopt MTD to the next business financial year rather than the next VAT period would also address a similar problem which will arise in future for businesses which have not previously been required to register for VAT but due to business growth cross the threshold part way through their financial year.

Addendum to the VAT Notice: VAT customer journeys (including soft-landing)

29. We welcome the provision of the examples of customer journeys in the addendum. We would like an additional example to be developed and included to cover the scenario of a large non-corporate group – for example a large estate - involving different (but linked) entities (partnership, sole trader, trust), several activities and using multiple accounting systems.
30. The interaction between the VAT Notice and the addendum needs to be addressed. Currently there are examples in the VAT notice and in the addendum – but they do not always appear to be consistent in their approach. It would be easier for business users of the Notice to have one set of examples/customer journeys and to include all the examples in appropriate sections of the VAT Notice, rather than splitting the examples between the Notice and the addendum.
31. In line with our suggestion for the examples, we also recommend that any parts of the introductory text in the addendum, which are not already reflected in the VAT Notice, should be incorporated into the VAT Notice.
32. The two soft-landing scenarios do not go far enough. An additional 12 months may not be sufficient for some businesses and charities to develop and implement the end to end digital systems envisaged, particularly as they will be dealing with Brexit-related system changes over the same period. We suggest increasing the period to 24 months.
33. We also envisage that there may be problems with other scenarios – the addendum examples assume, for example, that digital transfers of data from spreadsheets to bridging software will be possible in all cases, even though the software to do this does not currently exist.
34. The soft-landing approach should therefore be extended to cover all end to end digital problems encountered by businesses for the 24 months from April 2019. This would recognise that moving from a position where only 12% of VAT returns are filed direct from software to 100% direct filing is a significant challenge – which businesses should be helped to meet rather than being threatened with penalties, if software solutions cannot be developed and implemented by April 2019.
35. Businesses should not have to rely on an HMRC concession to avoid penalties. The soft-landing approach should be included in the regulations, or in part of the VAT Notice which has the force of law.

Records which need to be kept digitally

36. VAT Notice section 3.3 (relating to 32A in the regulations) sets out records which need to be kept digitally.
37. For outputs (32A(3)(f)) the business must record the outputs value for the period split between standard rate, reduced rate, zero rate, exempt and outside the scope. The regulations refer to the proportions – the VAT Notice suggests actual amounts. To calculate the proportions, it would be necessary to know the amounts, but it would be useful for the wording to be consistent.
38. Clarification is also required on the meaning of 'outside the scope'. Is this intended to refer to overseas supplies which would have been taxable if supplied in the UK? Or does it have a broader meaning? Currently, income completely outside the scope of VAT does not have to be reported so many accounting systems will not be configured to record or produce the information. Including this requirement in the regulations will add to complexity for many businesses and charities.
39. The inclusion of 'outside the scope outputs' in the voluntary supplementary data also suggests that the intention may be to change reporting requirements to make reporting this information mandatory too. If so this needs to be made explicit so that business can prepare. Given the difficulties businesses will already have with implementing MTD

in the time available it would be preferable not to require additional record keeping or reporting.

40. For inputs (32A(3)(b)) section 3.2 of the VAT Notice states that for each supply 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.
41. 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 of the regulation and the guidance in the VAT Notice need to be amended to make clear that any of these three approaches will be acceptable.

Approved software

42. The regulations (31AA and 32A) state that functional compatible software must take a form approved by the Commissioners in a specific or general direction. The VAT Notice in section 3.2 indicates that HMRC will provide a list of software. Presumably, HMRC will only include software on their published list if it is 'approved'.
43. HMRC already provide a list of software suitable for filing CT returns. However, we would like to see considerable improvements in the approach adopted for VAT. Businesses are likely to need help in identifying software suitable for their needs – this is not provided by the CT listing. We appreciate that HMRC cannot recommend particular software, but it would be helpful if the list for VAT provided additional information on the key features of products, price ranges and whether they are for agents or businesses (or both), so that businesses can easily identify products which might meet their requirements – and make comparisons. Flow charts might be helpful.
44. The list needs to be available for businesses as soon as possible. We are already aware of businesses actively looking to change software for business reasons but having difficulty doing so until they know that their preferred option will be 'approved' for MTD. They are being faced with the choice of not implementing now, meaning they have insufficient time to test properly before April 2019 - or implementing now but then potentially finding they are operating 'unapproved' software.
45. As the examples in the VAT Notice and the addendum illustrate, many businesses will not be using one standalone piece of software; they will be using combinations of different software and spreadsheets. It is not clear how a business will be able to ensure that their combination is 'approved', particularly if it includes any bespoke elements. Will there be a process for obtaining approval? If not, we believe that no penalties should be applied where a business reasonably believes that its arrangements are appropriate but HMRC later decides they are not.
46. Section 3.4 of the VAT Notice and examples in the addendum also mention adjustments that do not have to be made in software. The adjustments can be made by manual intervention. Again, it is not clear how businesses can be certain that their use of manual interventions for adjustments will be acceptable to HMRC.
47. The examples in the addendum give some indication, for example, partial exemption is mentioned specifically. Some examples were also mentioned in the legislation overview

published last year – but these have not been included in the VAT Notice. It would be helpful to expand section 3.4 to provide more guidance to businesses - and to charities (which are likely to have many adjustments to make).

Retention of records in software

48. In our comments on the VAT legislation overview published last year we raised issues arising from the requirement to retain records in software. We noted that keeping records for 6 years in software (and maintaining access to them) might involve significant costs; this could be particularly onerous where a business deregisters when it ceases trading (but has to continue paying for software for 6 years), or where a business moves from one software provider to another (where it might have to pay for both the old and new software for the next 6 years). There may also be problems where a software provider goes out of business.
49. We understand that HMRC is considering how these issues can be addressed. It is important that all the scenarios are dealt with – not just deregistration. We do not anticipate that businesses will change their software on a whim – but business needs change over time so software which was originally appropriate may cease to be so. If a product is withdrawn or a supplier goes bankrupt a business might have no choice about switching to a different provider.

Spreadsheets

50. Many businesses use spreadsheets: the government confirmed (in the MTD consultation response) that businesses would be able to continue to do so under MTD (in combination with software). This needs to be properly reflected in the VAT Notice and the Regulations. Currently, the regulations do not mention spreadsheets at all; it needs to be made clear that they do qualify as 'functional compatible software'.
51. In the VAT Notice spreadsheets are referred to in the examples – but noticeably excluded from key parts of the guidance. For example, section 1.2 giving background information, section 3.2 (excluding the examples) covering functional compatible software and section 4.1, making returns. These sections do not identify spreadsheets as functional compatible software and do not cover the use of spreadsheets in the MTD process. This needs to be addressed and the text needs to provide explanations to cover the references to spreadsheets in the examples.

Voluntary updates

52. As explained above we believe that the interaction between MTD for VAT and MTDfB should be addressed before mandatory implementation of MTD for VAT.
53. If MTD for VAT goes ahead from April 2019 we cannot see any point in including the option of voluntary updates. As section 5.1 of the VAT Notice makes clear they are only likely to have any real purpose at a future date. Until then the option only seems likely to cause confusion. It offers no benefits but would require extra work – particularly if an update turned out to be incorrect, as it would apparently have to be corrected (despite not creating a legal liability or discharging the return obligation).

Supplementary data

54. In our comments on the overview of VAT legislation last year we raised questions and made some suggestions in relation to supplementary data. We welcome the confirmation in section 6.2 of the VAT Notice that the information can be sent with every return or only on an occasional basis.
55. However, we also suggested 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. This has not been adopted. We remain dubious about the suggested benefits for businesses from submitting supplementary data. Section 6.1 of the VAT Notice indicates that it might mean that a business could avoid a

compliance check if the data provides assurance that the return is correct. This would surely be more likely if businesses could tailor the additional data they provide.

56. In our previous response we also suggested that offering more tangible, visible benefits (we gave two possible examples around deemed reasonable excuse and timing of payments/repayments) would provide an incentive to businesses to submit supplementary data. We are disappointed that this has also not been taken up.
57. There are concerns that the real intention behind the supplementary data option is that the submission of the supplementary data listed should rapidly become mandatory. If so this should be made clear – with the proposed timeframe – so that businesses can bear it in mind when selecting software and making their preparations.

Agents

58. The VAT Notice needs to provide more explanation of how agents and clients can work together in the MTD process and to recognise (through explanatory text and linked examples) that agents may have a role which goes beyond merely submitting the VAT return for a client. Agents could be maintaining records for clients and will often be checking returns and making adjustments and/or corrections before submission.
59. Section 4.1 of the VAT Notice is hard to understand when read in conjunction with Section 4.2 (particularly the second example). There should be more explanatory text about the interaction between agents and clients, recognising the differing levels of agent involvement, and the examples should be directly related to the text so that they enhance understanding.
60. The final slide in the addendum covers ‘the agent journey’ – giving a scenario where the client maintains the digital records, but the agent makes adjustments and submits the VAT return. As with the other examples in the addendum this needs to be integrated into the VAT Notice, together with suitable explanatory text. The left-hand ‘speech bubble’ also needs to be amended to clarify that the agent does not have to make the correction back into the client’s digital records. As confirmed by HMRC at a recent meeting it should be made clear that it will be sufficient for the agent to tell the client to make the correction.

Information from third parties and others

61. Concerns have been raised around situations where a third party collects income and incur expenditure on behalf of someone else. One important example would be letting agents dealing with property income and expenditure on behalf of landlords and providing them with information for their VAT returns. Another would be charities which often use event organisers, or local branches of the charity, to run fundraising events – taking money and paying costs – and reporting to the charity’s head office for the VAT return.
62. There is a lack of clarity about how the requirements for end to end digital will apply in these (and similar) circumstances. It would be useful for HMRC to develop examples to illustrate what they expect and include these in the VAT Notice. HMRC appeared to suggest at a recent meeting that in the case of letting agents, full digital transmission will be required. If so it should be made clear that the soft-landing approach will apply to these situations, as it is very unlikely that all third parties and recipients of the data will be able to put this in place by April 2019.

Security

63. Businesses have serious security concerns about the connection between their accounting systems and the HMRC API – which requires 2-way access so that HMRC can ‘push’ information to businesses.
64. We have received feedback that some 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. This will require

extra work at a time when businesses are currently prioritising time and resources for contingency planning and preparation for Brexit.

- 65. There is also a lack of clarity around liability for any security breaches or loss of data – given the involvement of HMRC and third-party software providers. The position needs to be made clear before businesses start using the new system.
- 66. This is another reason for introducing MTD for VAT on a voluntary basis and only switching to mandatory implementation when a range of significant issues have been addressed.

Assertions about MTD in the VAT Notice and Explanatory Memorandum

- 67. Both the VAT Notice and the Explanatory Memorandum include assertions about MTD which are not universally accepted (see for example, section 1.2 of the VAT Notice and paragraphs 7.6 and 11.2 of the Memorandum). It is important that these documents stick to explaining the legislation in a factual way that will help users to interpret the rules and understand what they need to do. The inclusion of what could be seen as unproven ‘propaganda’ for MTD is unhelpful and these assertions should be removed.

Communication with businesses and charities

- 68. As noted above we believe that mandatory implementation should be deferred. Introduction on a voluntary basis over a longer period would mean that communication with businesses and charities could take place in stages, as and when more software becomes available and the pilot expands.
- 69. However, if the April 2019 date remains unchanged it is essential that HMRC begins to communicate with businesses and charities now. We understand that HMRC is planning communications (and Talking Points webinars have been arranged for agents in February), but action is required urgently to ensure that businesses are aware of what they will need to do. The lack of software and limited access to the pilot are problematic but businesses still need to be put on notice so that they can start their preparations as soon as possible.
- 70. It is also important that HMRC provides clarity on its plans for the future development of MTD and the interaction between the different strands of MTD – for business income tax, personal income tax, VAT and CT. Businesses (large and small), software developers and individuals need to have some idea of what will happen in future and what this will mean for compliance.