Finding the way

Indirect Tax OMB



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Sharron West provides an update on how MTD will affect small and micro businesses

Key Points

What is the issue?

There have been many changes to the Making Tax Digital for Business proposals over the past 12 months or so which are not all widely known. There are also several

areas where rules have yet to be finalised.

What does it mean for me?

Clients need to be aware of what affects them and when so they know what changes they need to make to be MTD compliant, possibly before April 2019. Practitioners need to consider what additional support clients may need and how they can provide this.

What can I take away?

The revised timeframe means that the immediate priority is getting clients with turnover above the VAT threshold ready for the implementation of the MTD for VAT regime in April 2019. Other clients should also be encouraged to prepare for MTD more generally.

Many practitioners will have typical self-employed sole trader and partnership clients who rely mainly on their own skills to generate income for their business. Often they are not looking to expand to become much larger business entities, but are profitable enough to sustain their lifestyle. These would perhaps be individual consultants, tradespeople, retailers, restauranteurs or combinations of family members such as husband and wife, father and son, running the family business.

When Making Tax Digital for Business was first announced, these clients were the types of businesses HMRC had in mind when developing the new regime but there have been many changes since the original proposals were put forward, not least the swift rebranding of the project from ‘Making Tax Easier’ to ‘Making Tax Digital (MTD)’.

The fundamental principles of Making Tax Digital for Business are that business records must be kept in digital form unless exempt, quarterly updates must be submitted to HMRC to report business income and expenses, and an annual End of Year submission must be made with final accounts information and details of other taxable income.

This article looks at where we are now on the Making Tax Digital road for small businesses and identifies key areas where the rules are still to be finalised.

The current timetable

The original ‘go live’ date of April 2018 for MTD for Business was abandoned in July 2017 when HMRC succumbed to pressure exerted from all quarters over the unrealistic timescale they were working towards. As small scale pilots of the MTD regime were nowhere near ready to be scaled up to any sizeable numbers at that time and there was no time to pilot a complete MTD ‘cycle’ by then, most outside of HMRC considered this deferral to be absolutely necessary.

Businesses with turnover below the VAT threshold had already been deferred from joining MTD by 12 months to April 2019 following an announcement in the March 2017 Budget, but the statement by Mel Stride MP, Financial Secretary to the Treasury, in July 2017 confirmed that digital recordkeeping would only be required for those with turnover above the VAT threshold from April 2019 and then only for VAT purposes. The requirement for compulsory digital record keeping more generally and the submission of quarterly updates is now in abeyance until at least 2020.

Making Tax Digital for VAT

This shift in the immediate focus of the digital programme towards VAT registered businesses still has the potential to affect many small business clients. There are many businesses who may be VAT registered due to the level of their turnover but nonetheless may only make relatively modest profits due to significant expenditure on supplies and sometimes payroll costs. But the planned introduction of MTD for VAT in April 2019 means the timeframe is once again very tight for software to be developed and tested and for businesses to get fully prepared.

Software and spreadsheets

One of the main concerns is the transition for many small businesses to software which is compliant with the MTD for VAT requirements. As the majority of VAT registered businesses submit their VAT returns via HMRC’s online portal, they will have to be prepared to adopt new methods of dealing with their quarterly VAT returns from April 2019 as the online portal will no longer be available to them. HMRC want businesses to use commercial software which enables them to keep their business records digitally and also allows them to file their VAT returns from within the software itself, so the information is transmitted directly to HMRC without

being subject to any extraneous intervention and therefore potential error.

However, HMRC have accepted that many businesses use spreadsheets as their main recordkeeping tool. This is particularly the case for smaller businesses where there may be limited digital expertise within the business itself, or where the simple nature of the bookkeeping entries means it is not necessary to use more complex accounting software. It is also anticipated that many less sophisticated businesses who have historically kept adequate business records based on till rolls and supplier invoices, and recording data in handwritten cash books, may be persuaded to digitise their records by moving to a spreadsheet-based system, as a transition to formal accounting software could be a step too far.

HMRC has confirmed spreadsheets constitute digital records, and so with this in mind, HMRC is proposing that some kind of Application Program Interface (API) enabled spreadsheets and/or bridging software is developed to enable VAT returns to be filed from the spreadsheet records. HMRC made it clear from the outset of the MTD project that they would not be producing any MTD compliant software themselves, and therefore development of commercial software to meet the requirements of digital recordkeeping for MTD for Business generally has been under way for some time. Incorporating a VAT filing feature which is MTD compliant in these products where there is not such a feature already is unlikely to be too difficult, however, to develop from scratch a new product such as an API enabled spreadsheet and/or bridging software of some kind in such a short period of time and to thoroughly test it is challenging to say the least. This assumes software developers see a business opportunity for such software and are happy to invest resources into it.

So business clients who are not currently using any formal accounting software to keep their records must decide whether to take the plunge – and financial hit – and invest in compliant software and associated training, or hang on and see whether HMRC’s proposals mean that spreadsheet-based products emerge onto the market which are affordable and make digital recordkeeping and quarterly VAT filing manageable for the less digitally capable. But time is ticking on to decide on a new or modified record keeping system, and get it up and running (smoothly) by April 2019.
HMRC are requiring the software companies to produce basic software that is generally MTD compliant at no cost as part of their terms of collaboration agreement. This must be suitable for use by a business which is not VAT registered

and does not have any employees. There is no requirement for free software to be produced which is MTD for VAT compliant and so all VAT registered businesses with turnover above the VAT threshold will be compelled to incur the additional investment in software – and maybe hardware for some, where paper-based records or old equipment have been previously used.

Start date

The Value Added Tax (Amendments) Regulations 2018 were laid on 28 February 2018, just 21 days after the end of the consultation period relating to the draft regulations. They confirm the start date from which a business must submit VAT returns under the new regime will be the first VAT quarter beginning on or after 1 April 2019. This is despite pressure from the professional bodies and others for it to be effective from the first accounting period beginning on or after 1 April 2019.

It must be remembered that MTD for VAT is only mandatory for businesses with turnover above the VAT registration limit. Therefore those who are voluntarily registered can choose to comply with MTD for VAT but do not have to do so. They should be able to continue filing online returns via the HMRC portal at least in the short term. Once the VAT threshold for compulsory registration is reached, MTD for VAT becomes mandatory for the business, regardless of the level of turnover in the future.

Testing the new regime

Pilots of MTD for Business have been under way for some time now, initially with just a handful of businesses. More businesses have gradually volunteered to join the pilots but they are still on a relatively small scale. They are of course dependent on the software companies having their MTD compatible software ready, and so the main group making up the test population initially were customers of the software companies, so those who are already digitally capable to a significant degree. The record keeping aspects and the submission of quarterly updates are all forming part of the pilot programme. HMRC will be gradually widening the scope of the pilots so the system can be tested for all potential user groups and tweaked as necessary. HMRC plan to use the findings from the pilots to inform them as to the kind of support and assistance businesses will need from them in due course to enable compliance with their MTD duties. Unfortunately to date there has been very little feedback from HMRC as to how the pilots are going.

We understand that pilots of the MTD for VAT regime were due to commence in April 2018. Hopefully HMRC will be able to recruit volunteer businesses into the pilots quickly, and sufficient versions of the software will be available to make the pilots worthwhile, as this start date only leaves a 12 month window for the testing.

The digitally exempt and digitally excluded

Where annual business turnover is below £10,000 none of the MTD provisions will apply. It will also be possible to apply for exemption from MTD due to being digitally excluded,that is where it is not reasonably practicable to comply with digital obligations on such grounds as disability, age, remoteness of location etc. The procedure for applying for exemption has not yet been confirmed but the regulations indicate it will be a system where exemption requires explicit approval from HMRC and will not be a self-certifying process.

Conclusion

It is evident that there is a lot for the small business to have to contend with in order to comply with MTD over the coming months and years, but unfortunately there is still a lot of detail to be finalised in a very limited amount of time. As more legislation and regulations are passed by Parliament, more of the 'fine print' of the MTD regime will become clearer and we can then help clients navigate their way through the MTD maze accordingly.

Further information

For more resources on helping small business deal with MTD, please visit the CIOT's website and LITRG's website.

For a practitioner's experience of helping to prepare clients for the shift to MTD, see Dale Simpson's article, 'The silver lining in the Cloud' in the February 2018 issue of Tax Adviser.