

Making Tax Digital

# A guide to MTD and what it means for businesses

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# Making Tax Digital for VAT

## What you need to know

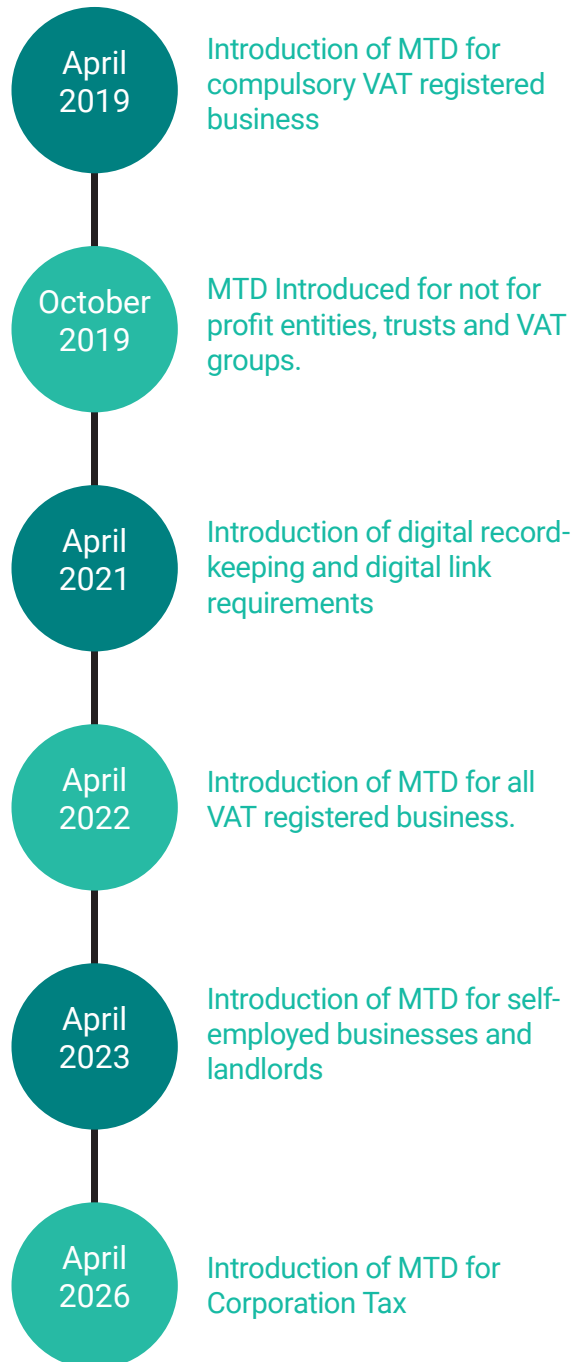
Making Tax Digital (MTD) is an HMRC initiative to provide transparency to tax returns by digitalising reporting. It has been discussed for some time, and began in April 2019, so further developments and roll out come as no surprise to business owners.

Many businesses took swift action to satisfy the requirements of MTD; however, on 1 April 2021, phase 2 of MTD requirements come into effect, and the initial 'soft landing' period comes to an end.

Businesses will therefore start to incur financial penalties for not complying with the MTD requirements for VAT periods starting after 01 April 2021.

This short guide outlines the requirements of the legislation, explains the impact on business day to day and provides guidance on how to prepare.

With the right guidance and advice, we are finding businesses aren't having to make substantial changes to their current systems and processes to remain MTD compliant. However, many businesses are taking the opportunity to update their accounting and financial systems to make the business more efficient as well as MTD compliant – particularly as many SMEs can currently apply for grants of between £1,000 and £5,000 to help them access new technology, equipment as well as professional, legal, financial or other support.



# What are the implications for your business?

## Phase 2, what's changing and when?

The overall requirements for MTD are mostly unchanged and remain as they were originally when introduced in April 2019. There was originally a yearlong soft landing period to allow businesses to adapt to the new requirements. Due to end on 01 April 2020, it was extended to 01 April 2021 due to COVID19, but now ends on 01 April 2021; meaning businesses will have to comply fully with the MTD requirements or face financial penalties.

## Requirements can be broken down into three main areas:

### Submission to HMRC through compatible software

The first phase of MTD required businesses to make their VAT submissions through "functional compatible software", software that can connect to HMRC via an Application Programming Interface (API).

This has been standard procedure now for most VAT registered businesses for periods starting after 01 April 2019. HMRC include details of a wide range of compatible software on their website. However, not all legacy systems allow a direct link to HMRC and require the use of bridging software to complete the filing to HMRC.

There is no longer the option to submit your return through the Government Gateway. If you are already registered for MTD or if you have a taxable turnover exceeding £85,000.

### Digital record-keeping

Businesses are obliged to maintain VAT transactional data in digital form. MTD does not require you to keep additional records for VAT to what you have previous but does require you to maintain them in a digital format. This was a

requirement during Phase 1 of MTD; however, there were previously no implications for businesses who didn't keep their records digitally due to the soft landing period.

Your digital records should include information about your business, not limited to; business name, principal business address, your VAT registration number and details of any VAT accounting schemes you use.

For each transaction in your VAT records, you should record the time of supply (tax point), the value of the supply (net excluding VAT) and the rate of VAT charged.

### Digital links

In addition to the original requirements from Phase 1, it is now a requirement for the software applications a business uses to maintain their VAT records and to file the VAT return to be 'digitally linked'.

This requires the transfer of digital data between software programs or applications to be automated. The digital journey through the system must be uninterrupted,

### Who do the changes relate to?

- Any businesses with taxable turnover above the VAT registration threshold (£85k).
- Unlike for Phase 1, there is no deferral for not for profit organisations, VAT groups or trusts.
- From 1 April 2022, the introduction of phase 3 of MTD, will mean all VAT registered businesses must be registered for and compliant with the MTD regulations.

# What are digital records?

To show the link between the output tax in your records and the output tax on the return, you must have a record of:

- The output tax you owe on sales
- The output tax you owe on acquisitions from other EU member states
- The tax you are required to pay on behalf of your supplier under a reverse charge procedure
- The tax that needs to be paid following a correction or error adjustment
- Any other adjustment required by VAT rules.

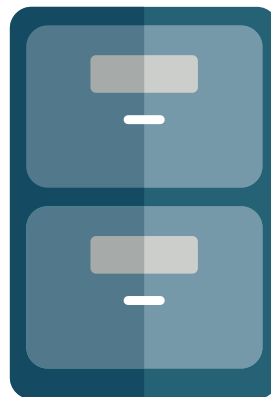
For each supply you receive, you must record:

- The date
- The value
- The amount of input tax that you will claim.

To show the link between the input tax in your records and the input tax on your return, you must have a record of:

- The input tax you are entitled to claim from business purchases
- The input tax allowable on acquisitions from other EU member states
- The tax that you are entitled to reclaim following a correction or error adjustment
- Any other necessary adjustment.

The complete set of digital records to meet MTD



requirements do not all have to be in one piece of software. If there is a digital link between the pieces of software, records can be kept in a range of compatible digital formats.

If you make multiple supplies at the same time, these do not have to be recorded separately. You can record the total value of supplies on each invoice or receipt that have the same time of supply and rate of VAT charged.

# What are digital links?

A digital link is an electronic or digital transfer or exchange of data between software programs, products and applications. Once data has been entered into software (or a group of software products) used to keep and maintain digital records, any further transfer, recapture, or modification of that data must be done within the system or by using digital links.

Therefore transferring data manually, including cutting and pasting, within or between different parts of a set of software programs, products or applications that make up functional compatible software is not acceptable under Making Tax Digital.

In particular, this highlights the importance of VAT transactional data (i.e. the information for a VAT supply or purchase) being first recorded digitally, so handwritten invoices, receipts or sales summaries will no longer be MTD compliant and cannot form part of your digital records. Information must be created electronically or entered straight into a digital system (an excel spreadsheet is fine for this purpose).

## What constitutes a 'digital' link?

### Per HMRC definition, a 'digital link' includes:

- Automated data transfer or integration of two systems.
- API transfer
- XML, CSV import and export, and download and upload of files. This includes export from one system to excel/CSV and the upload into another system (provided no manual intervention/manipulation is required).
- Import/export where information is transferred by digital means – i.e. emailing a spreadsheet containing digital records to a tax agent so that the agent can import the data into their software.
- Linked cells in spreadsheets; for example, if you have a formula in one sheet that mirrors the source's value in another cell, then the cells are linked.

### Example of what does not constitute a digital link:

- Manually entering information from non-digital records into an excel spreadsheet or accounting system – i.e. from a cashbook/handwritten sales summaries.
- The use of 'cut and paste' to select and move information, either within a software program (such as excel) or between software programs.
- Any manual adjustments and consolidations of group returns in spreadsheets.

# Following April 2021

## Actions for business owners

### If you currently use cloud-based accounting software

Most cloud-based software is fully MTD compliant and will allow you to keep your records digitally within the accounting system, including raising invoices. Xero, QuickBooks Online and Sage One are all MTD compliant; however, if you are using different cloud-based software, your provider should be able to confirm if their product is MTD compliant.

### If you currently use non-cloud based accounting software

Most of the larger software companies are able to offer MTD compliant versions of their products. However, most software companies are requiring updates to the latest versions or the purchase of an MTD module.

There are some older versions of software that may not be MTD compliant. You should be able to obtain advice and support from your existing provider, but if you would like to double-check with us, then please do give us a call. If your current system is not MTD compliant, we may still be able to offer a solution.

### If you currently use spreadsheets

Maintaining your accounting information in spreadsheets is sufficient, and HMRC considers a spreadsheet to be a digital record.

Your processes may require change if you currently collect data outside of excel or keep records manually and then type them up afterwards. The MTD regulations state the first point of entry into the accounting records must be digital.

You must also ensure the system you use for your VAT

filing, such as bridging software, is digitally linked to your records in the spreadsheet.

You may want to consider an accounting system or applicable software solution, most cloud-based accounting systems are very easy to use and are available at a reasonable cost. Using a cloud-based accounting system would also likely reduce your annual accountancy fees and provide further efficiencies.

Please get in touch if you would like to discuss the options available to you, we would be happy to provide support.

### If you currently maintain records on paper

Your processes must now change regardless of if you have been using bridging software to make your VAT filings or not.

You will need to use an appropriate software solution to keep your financial records. Or alternatively, engage an agent to keep your financial records and make the VAT filings on your behalf. We would be happy to assist you in choosing appropriate software or can provide a quote for us to maintain your records on your behalf.

# Can you still use bridging software?

The end of the soft landing period does not mean the end for bridging software, although you may need to make some changes to the way in which it is used to accommodate the requirement for unbroken digital links.

You can no longer manually enter information into bridging software for submission, nor can you use copy and paste to move data into your chosen filing software.

If your accounting software is unable to make the VAT filing directly, then you may still be able to use bridging software to make the submission; however, your accounting system would need to be digitally linked to the bridging software. This can include exporting the VAT return data into excel and linking it to bridging software, provided there is no manual intervention required - such

as copying and pasting information or manually typing/entering figures.

Businesses can still choose to keep their records in spreadsheets, providing digital links are present through to the submission using compatible bridging software.

Please get in contact with us to discuss if you have any questions regarding proper use of bridging software.



# Post-April 2021



## Will there be penalties if a business is not ready on 1 April 2021?

For VAT periods starting on or after 1 April 2021, you must keep your records digitally, and systems must use digital links for any transfer or exchange of data between software. HMRC have confirmed penalties will be charged for non-compliance after this date; however, the amounts of the penalties and what they will be issued for are yet to be confirmed.

Late payment and filing penalties will certainly apply, and not being able to file due to MTD will no longer be a viable excuse for late filing.

## Are there any exceptions, or are there extensions available?

Businesses with complex or legacy IT systems may require additional time to put digital links in place across their platforms. These businesses can apply for an extension; however, these will be reviewed on a case by case basis.

If you have made a recent acquisition of a business, you may be granted more time to implement digital links to meet MTD obligations.

HMRC have made it clear that the cost of implementing a compliant system on its own is not sufficient reason to be granted an extension. Businesses are expected to make every effort to comply with the digital links and record-keeping requirements by the end of the soft landing period.



# MTD timeline

April  
2019

## Phase 1

Introduction of MTD for compulsory VAT registered business, meaning filing required through compatible software but soft landing period in place for digital records and digitally linked systems.

October  
2019

Phase 1 of MTD Introduced for not for profit entities, trusts and VAT groups.

April  
2021

## Phase 2

Introduction of digital record-keeping and digital link requirements for all VAT registered businesses. End of soft landing period, introducing fines and penalties for non-compliance with Phase 2 obligations.

April  
2022

## Phase 3

Introduction of MTD for all VAT registered business.

April  
2023

## Phase 4

Introduction of MTD for self-employed businesses and landlords with annual trading revenue or property income above £10,000.

April  
2026

## Phase 5

Introduction of MTD for Corporation Tax, all businesses will have to make quarterly submissions to HMRC in relation to Corporation Tax.

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