

The Complete
Guide to **Making**
Tax Digital



Your business accounting must go digital. Now!



That's what the government says anyway. We're afraid you don't have a lot of choice in the matter.

Many businesses are on board with using technology in some way, shape or form for their accounts. Most will be familiar with desktop or cloud accounting/invoicing software, and most banks now offer expenses categorisation as part of their business bank accounts. For the tech savvy, most of this is a doddle and only a minor inconvenience.

However, many have no desire to live in a digital world. The thought of 'snapping and sending' their receipts or managing a bank feed into some software brings them out in a cold sweat. They just want to get on with running their businesses. They have no desire to spend their time faffing around with software.

For those people, HMRC has recently made life a little bit more difficult for them.

The UK government is making businesses jump through a few more hoops when it comes to submitting their returns to HMRC. It is insisting that businesses become proficient with doing all of their accounting digitally. That means using software and undertaking digital record keeping.

Currently, it only applies to VAT registered businesses – but it won't be long until it will be required from all businesses – VAT registered or not.

For now though, the law stipulates that VAT-registered businesses must use digital software to record, store and submit their VAT information as part of Making Tax Digital (MTD).

In practice that means that you can no longer file your VAT return directly onto the HMRC website. You have to use a piece of software to do it, either via your own subscription or via an accountants.

It's all part of Making Tax Digital.

About the author

Lucy Cohen is the co-founder of Mazuma – the UK's first subscription-based accountancy service. Founding the company in 2006 at the age of 23, Lucy spotted a gap in the market for low cost, hassle-free accountancy services.

Mazuma was created drawing on Lucy's childhood experiences of seeing the stress and anxiety that tax can cause for people. Growing up in a family of self-employed creatives she noticed that they were fantastic at what they did, but not so great with the tax and accounts side of their businesses. Spotting a gap in the market for low cost, subscription-based accountancy services, Mazuma was born.



With her co-founder Sophie Hughes, Lucy has created an unconventional business model in a traditional service industry and has been at the forefront of revolution in the accountancy industry ever since.

Since 2006 the company has become one of the largest providers of small business accountancy services in the UK and in 2021, launched their own proprietary technology specifically to help small and micro businesses meet the requirements of MTD. Now, Mazuma services clients all across the UK and Lucy remains committed to and passionate about innovation and technology within the service business sector.

She loves small and micro businesses and strives to be ahead of the curve in an industry that has historically been resistant to change.

With over 15 years at Mazuma, and 19 years in total in the accountancy industry, Lucy is widely recognised as an industry expert and regularly called upon to contribute to trade publications and industry discussions. Her debut book, *The Millennial Renaissance* was released in 2017 and met with acclaim. She is a columnist for Accounting Web.

Lucy is proud to have been shortlisted for Director of the year (Innovation) by the Wales Institute of Directors in 2019 and crowned Welsh Disruptor of the Year at the Great British Entrepreneur Awards in 2019.

She has been named as one of the top Women in Accountancy and Finance 2020 and a finalist for Practice Pioneer 2020 at the Accounting Excellence Awards.

Lucy has been a volunteer for the Princes Trust since 2011 where she mentors and coaches start-up businesses.

What is Making Tax Digital?

HMRC says that its ambition is “to become one of the most digitally advanced tax administrations in the world”. It says that Making Tax Digital is **‘making fundamental changes to the way the tax system works’** – transforming tax administration so that it is:

- **more effective**
- **more efficient**
- **easier for taxpayers to get their tax right**

The government also hopes the move will avoid the tax errors that result in more than £9 billion worth of revenue a year.

You may well have already heard of Making Tax Digital, or MTD as it’s commonly referred to. There have been some well-known cloud accounting providers advertising their products for it on TV, and accountants have been begrudgingly writing about it for a couple of years now.

MTD for VAT is the first stage of this transformation of tax filing and record keeping, and means that businesses must now do their VAT accounting and VAT filing using software (desktop or cloud) and submit returns via the internet through digitally linked solutions. This actually became law on 1 April 2019.

If you’re currently VAT registered then this won’t come as a shock to you, and you’ll most likely have been in the group of applicable businesses that must now follow the new rules.

You may well have already got your solutions in place and have been successfully filing - in which case, bravo!

You should still read on though - there are changes coming to penalties and things are going to get a bit stricter. HMRC will be reviewing the penalty regime over the coming years and making them appropriate for MTD (more on that later). So if you’re reading this and aren’t sure you’re fully compliant yet, it’s better to be safe than sorry and make sure that you become compliant right away. And we’ll tell you exactly what that means in real life.

In short, MTD for VAT currently means the following:

- VAT Returns must be filed through HMRC-approved software: VAT-registered businesses with a turnover above the VAT threshold (currently £85,000) must submit their VAT Return using compatible and approved software. There is a list of approved software suppliers on the HMRC website. This means that it’s no longer possible to submit VAT Returns directly via HMRC’s website as you’ve been able to do for years. Don’t panic though! Your accountant can still submit the VAT Return on your behalf or you can choose a piece of HMRC-approved software to use.
- Businesses must now keep digital records: We’ll discuss what the definition of a digital record is later on in this guide, but in summary - most VAT accounting records relating to the VAT Return must be kept digitally and/or using software for the statutory legal period of six years (10 years for mini one-stop shop (MOSS) businesses).

How do I prepare for Making Tax Digital?

Ultimately, HMRC and the government have introduced Making Tax Digital to make accountancy more efficient for business owners through technology, and to reduce lost tax revenues for the Treasury.

HMRC conducted research to find out more about small businesses and agents' overall understanding of, and reactions to, the requirements of MTD. This included the use of digital record-keeping tools, updating HMRC quarterly and the option to pay more frequently than once per year.

How will businesses benefit?

Better use of information

In theory, MTD means that you won't have to keep giving HMRC information you've already provided in the past, or information it can easily source from elsewhere. The long term plan is that there will be more joined up thinking in the tax system so that taxpayers aren't unduly burdened with excessive tax administration each year. Most of the legislation is still in draft at this stage, though. It's hard to know for sure how far the system can or will go to make things easier for individual taxpayers and businesses alike.

Tax in real-time

HMRC can collect and process information which affects tax in real-time. This means you won't have to wait until the end of the year to find out how much tax you need to pay. This creates an opportunity for business owners to improve their record keeping and better understand their ongoing tax situation.

A single financial account

The plan is that, eventually, businesses will be able to see a comprehensive financial picture in a digital account, all in one place and on one screen.

Interacting digitally

You'll be able to interact digitally with HMRC when it best suits you. These interactions include a personalised picture of your tax affairs, prompts, advice and support through web chat and secure messaging.

Added value advice

HMRC's study found that some felt MTD would enable them to focus more on providing added value advice and services to its clients, rather than focusing on commodity services and record keeping and data entry.

What are the concerns over Making Tax Digital?

Although there are certainly benefits, some business owners and sole traders have also expressed concerns with Making Tax Digital.

New system

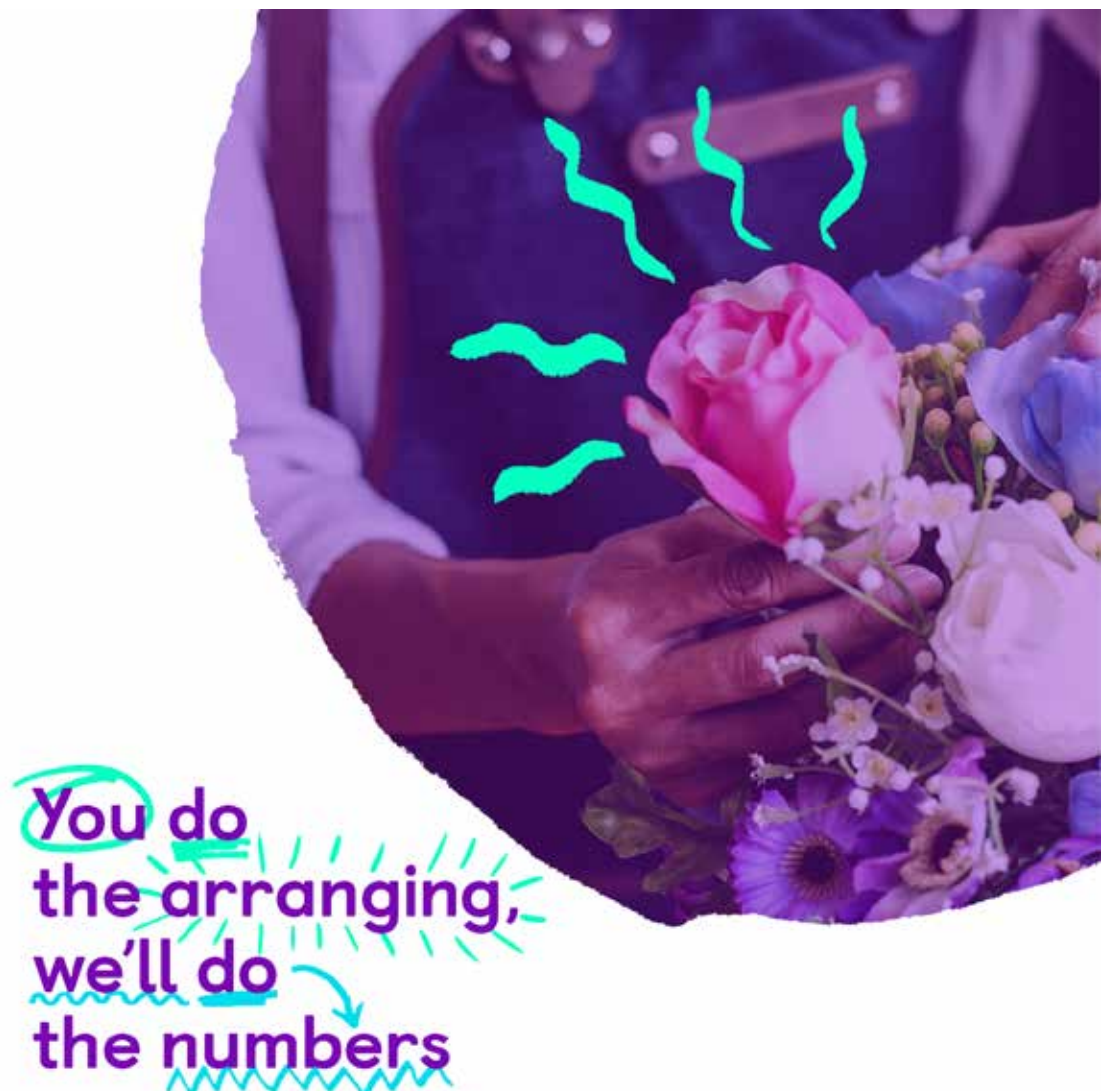
Many business owners, particularly those reluctant to keep digital records, believe the current system works for businesses of all sizes, suggesting there is no real need to introduce a completely new system.

Stress

Some are apprehensive that the nitty gritty details of exactly how the new system will be used could be too complicated and stressful.

Quarterly updates

Although more regular updates offer the opportunity to implement better record-keeping and greater awareness of ongoing tax situations, some describe quarterly updates as 'daunting'.



What does 'keeping digital records' mean?

Keeping digital records is a core aspect of Making Tax Digital. From now on you will need to keep your records in a digital format, stored on a computer or in the cloud.

MTD's process means businesses will no longer be able to use things like a ledger book or duplicate pad as their primary source of data storage. Likewise, a till that physically prints out a till report at the end of the day but doesn't store that information anywhere will need to be replaced with something that does.

If you produce handwritten invoices or receipts then you will have to transfer the accounting information to your MTD compliant software before you submit your VAT Return (or get your accountant to do it for you!). That can be quite the headache and take up a lot of your valuable time, which is why it's often better to pass it over to your accountants.

Keeping digital records doesn't mean you don't have to keep original paperwork. Quite the opposite, in fact. Original paperwork still needs to be stored as it could be required by HMRC in the event of a tax or VAT investigation. For most businesses, it means keeping paperwork for at least six years, though for many it is a minimum of 10 years. HMRC will accept digital copies of receipts and invoices, so you could scan documents and store them to save on storage space in the office. But who has time for that?

Getting ready for keeping digital records and MTD

Businesses can either submit information through their accountants or independently by using HMRC-approved accounting software.

Something we pride ourselves on at Mazuma is digitising records for our clients. Those who prefer more traditional methods or may be sceptical of a more digital future can send us all of their paperwork. We'll scan and digitise it for them, saving them a lot of admin hassle and keeping them completely compliant with current and future MTD rules.

If you wish to submit information independently using accounting software, be mindful that the software you use should remove most of the admin burden by default. Remember, if you are transferring data from paperwork into software, you must keep the original documents in case they are required by HMRC at a later date.

If you don't feel it is removing the admin burden, you should consider switching to a different software provider, or using an accountancy service.

Warning!

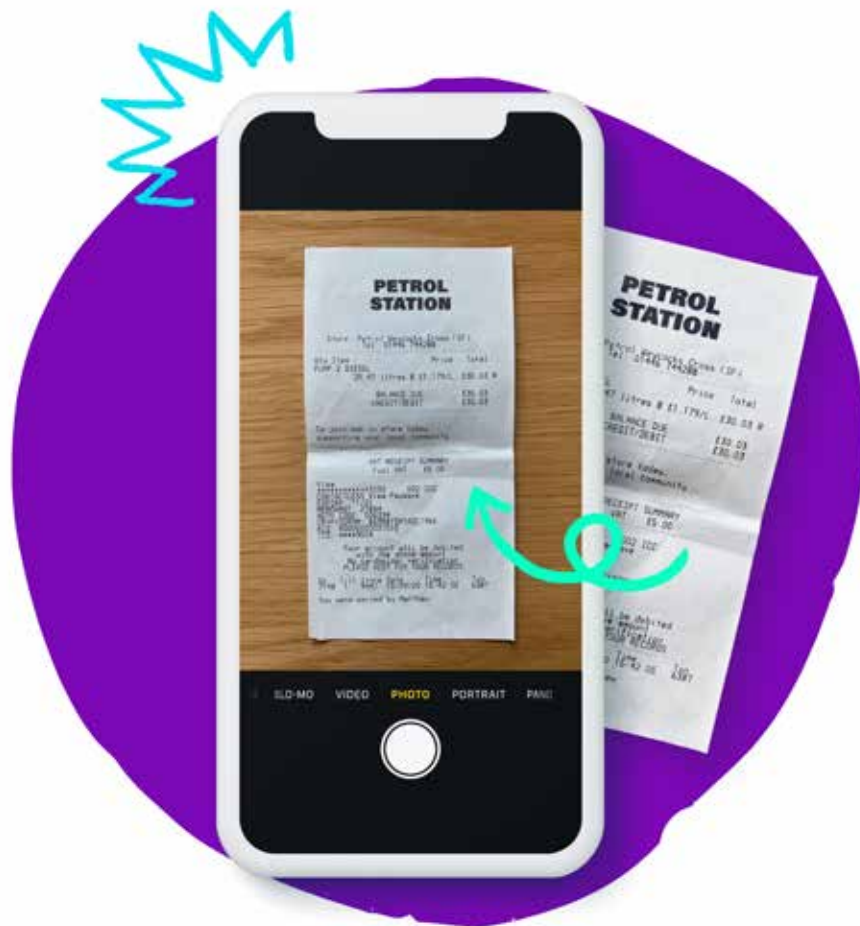
Be very careful if you rely on something other than approved software or an accountant. In our experience, many businesses still use Microsoft office software for their VAT accounting work. Although it is possible to be compliant this way, it comes with big risks.

To be compliant with Making Tax Digital, you must ensure that the data those files contain is not only kept for the required statutory period, but that it is stored without any risk of loss or corruption. The risk of Excel spreadsheet formulas or Word documents becoming corrupted, overwritten or deleted entirely is relatively high. Therefore, I would not recommend using Microsoft Office software (or similar) to keep digital records.

Which VAT records do I need to keep digitally?

If you want some further reading on which VAT records must be kept digitally, HMRC's VAT Notice 700/22(1) explains everything in plenty of detail.

You can find it [here](#) or search for it online.



What happens if I get it wrong?

This is always the bit that people want to know about: ‘How badly will it hurt me if I get it wrong?’

HMRC will be introducing a new penalty system over the next few years – one that is more suited to Making Tax Digital’s impact on VAT payments and record keeping. Likewise, when MTD extends to other filings there will doubtless be a review of the penalties applied for late or non-submission, as well as non-compliance

What we do know is that the current penalties for late payment will still apply, even if the filing deadline isn’t so strictly monitored in the first stages of implementation.

What are the current penalties?

Current rules state that a business defaulting on a VAT payment can be issued a Surcharge Liability Notice. That means that you could end up paying surcharges of 2, 5, 10% or more of the total of the defaulted amount, depending on how long the business remains in default or how many times you miss a VAT payment. Those penalties can add up quickly if you bury your head in the sand!

HMRC also has the power to issue additional penalties at its discretion for not keeping correct records, or when VAT Returns are filed incorrectly. HMRC can be especially strict on if it feels it has been deliberately misled by a business.

Regarding a future penalty system for Making Tax Digital, the Chancellor of the Exchequer said the following in his Spring Statement 2019:

“The government can confirm a light touch approach to penalties in the first year of implementation [of MTD]. Where businesses are doing their best to comply, no filing or record keeping penalties will be issued.”

The soft landing period for Making Tax Digital for VAT was due to end on 31st March 2020, marking the end of HMRC’s “light touch” towards non-compliance with the new rules. However, with Coronavirus having a significant impact on businesses throughout the UK, the soft landing period will now extend and only end from VAT periods starting on or after 1st April 2021.

So whilst the surcharge penalty system looks complicated and there might be a slight reprieve in the first stage on certain aspects of MTD filings, this doesn’t give you carte blanche to ignore the requirements of MTD, or to make deliberate or careless errors. It’s important to get into the correct practices as soon as possible so that compliance becomes second nature to you and your business. I cannot stress strongly enough that ultimately, you can be penalised for failing to either pay your VAT bill or for not trying hard enough to follow the new MTD rules – including digital links and keeping digital records.

As is to be expected, HMRC are checking up on businesses under the new rules. If you are unlucky enough to end up having a VAT inspection, don't panic! They are mainly interested in looking at how hard you have tried to get to grips with the legislation, even if you haven't done so successfully.

Despite its reputation, HMRC is very fair to businesses that are trying to comply and will offer useful advice and help to those that have, despite their best efforts, fallen short. If you've tried your best and been honest, you won't have anything to worry about.

What is the 'soft-landing period'?

HMRC is allowing a "soft-landing" period, which is different to the light touch for penalties outlined in the 2019 Spring Statement.

The soft-landing period refers to a slight relaxing of the technical rules on digital links. Digital links are a central part of how the legislation says MTD for VAT must perform within a business and refers to the specific technical way that data gets transferred to HMRC.

This soft-landing period will end though - or may have already ended depending on when you're reading this. The current 12 month soft landing period for digital links will end for VAT accounting periods starting on or after the 1 April 2021. Businesses that benefited from the deferred start date for MTD (VAT periods beginning 1 October 2019) have a further six months of the soft landing period until their first VAT period beginning after 1 October 2021. So some of you may still have a little time left.

I can hear you crying out at your screen:

"Hang on, did I read that correctly? There are technical rules on exactly how the data gets transmitted? I thought it just had to be via the internet and software!"

That's right. Not only does Making Tax digital stipulate that businesses must keep records digitally, but there are rules about how that digital data gets transmitted to HMRC. It can be a bit baffling!

In its simplest form, the rule says there must be some form of digital link between your business and HMRC. Usually, that involves an approved piece of software, as we mentioned earlier. That software can be owned by either the business or its accountant. Don't worry, if your accountant manages the process for you, their digital link counts as yours. You don't have to have the same piece of software as well.

It simply means no more punching your figures directly into the HMRC website.

It also means no copying and pasting figures onto the site either. That makes it trickier if you were planning to use a spreadsheet to keep your digital records. HMRC says that copying and pasting is not a true digital link, even if all records are kept digitally.

HMRC ultimately wants the flow of accounting data to be entirely digital, and therefore automated, which forms its definition of digital linking.

According to HMRC, if a user manually copies and pastes data then it is not an automated process, so isn't classified as a digital link. As far as HMRC is concerned, the future is all about data flow via automation.

Another tricky complication is that the rule applies even when copying and pasting data from within the same software. You cannot copy a figure from one box in your accounting software and pop it into a box on the VAT Return to file. Once the soft-landing period ends, it should be automatically pulled from somewhere else.

During the soft-landing period, HMRC has accepted 'copy and paste of data' as a form of digital link – mainly because so many businesses have struggled to adopt a compliant system, but also to make sure that the system really works before they lock it down. But HMRC has warned in the strictest terms that the soft-landing period is only to allow businesses time to update their old systems – so you shouldn't rest on your laurels, especially as the soft landing period ends on 31st March 2021 for many businesses!

I have a sneaking suspicion that many businesses have been using the copy and paste approach without realising that, at the end of the soft-landing period, they might be opening themselves up to be penalised. They may not have even realised that the solution they adopted in the first instance might be using the copy and paste option. So, are you sure you're compliant?

You guessed it - there are likely to be new penalties in the near future

It's likely that after the soft landing period and light touch approach ends, HMRC will update the penalties to be more in line with penalties for late filing and payment of income and corporation Tax - based on a penalty point system. That could look something like a penalty point for a missed return leading to a fine after four accumulated points for missed returns. And penalty points may last for two years before they expire.

As we have said before, it is much better to make the shift to an accountant or software that is MTD compliant sooner rather than later. Putting off switching, for whatever reason, could leave you with little time to manoeuvre when HMRC get stricter. It could end up leading to hefty penalties should you get it wrong.

Switch to an MTD-compliant solution now and let someone else worry about the digital flow of your accounting data!



What's the verdict?

By now, a lot of businesses will have adopted the digital approach of submitting their VAT to HMRC. If you haven't made the switch to digital bookkeeping yet, please do not panic! We're here to help you break it down.

In summary...

Making Tax Digital (MTD) means that it is now - or very soon will be - compulsory to use a digital bookkeeping system for submitting tax to HMRC.

The idea is that you choose a digital, cloud-based, software for your bookkeeping which, in turn, allows you to submit your tax return at the click of a button.

Alternatively, you use an agent who uses MTD-compliant software with access to your accounts so that everyone is using the same system, has the same information and is essentially singing from the same hymn sheet.

Some snazzy accountants, including Mazuma, even have their own app that helps you keep on top of your books and paperwork in real time, which makes the entire digital process much easier.

The updated deadline for Making Tax Digital

Because the UK government has been a little preoccupied with Coronavirus and Brexit, HMRC won't be enforcing MTD for any new taxes or businesses right now. This means that it's likely April 2023 will be the earliest start date for income tax returns to be compliant with MTD. That's good news because it gives everyone a little bit more time to get on board.

That said, it's really worth setting yourself up ahead of the deadline. And here's why...

Why Making Tax Digital is better for everyone

Efficiency

Feeling protective over your current bookkeeping system is understandable, especially if you've been using it for years. It might be scary to think about switching over to a new system and feel like you're starting all over again when you're so efficient with the current system. This is where an accountant or bookkeeper can prove extremely useful. When it comes to Making Tax Digital, using an online accountant is ideal. You won't have to worry about compliance, because they'll handle it all for you. When it comes to submitting your taxes quarterly, which is likely to happen - using a reliable accountant will give you peace of mind and ensure that your business is compliant and won't face any fines.

Ease of use

Whichever software you end up choosing, you can be reassured that it has been tried, tested and tweaked to make for the best user experience. Cloud-based bookkeeping is literally designed to be logical, simple and (dare we say?!) enjoyable to use.

Most (if not all) will have a swish looking dashboard that displays a quick overview of what's going on at any given moment; the ins and outs, bank balance, outstanding payments and so on. Of course, if this is something you don't want to spend your time on, you can always use an accountant to sort this for you.

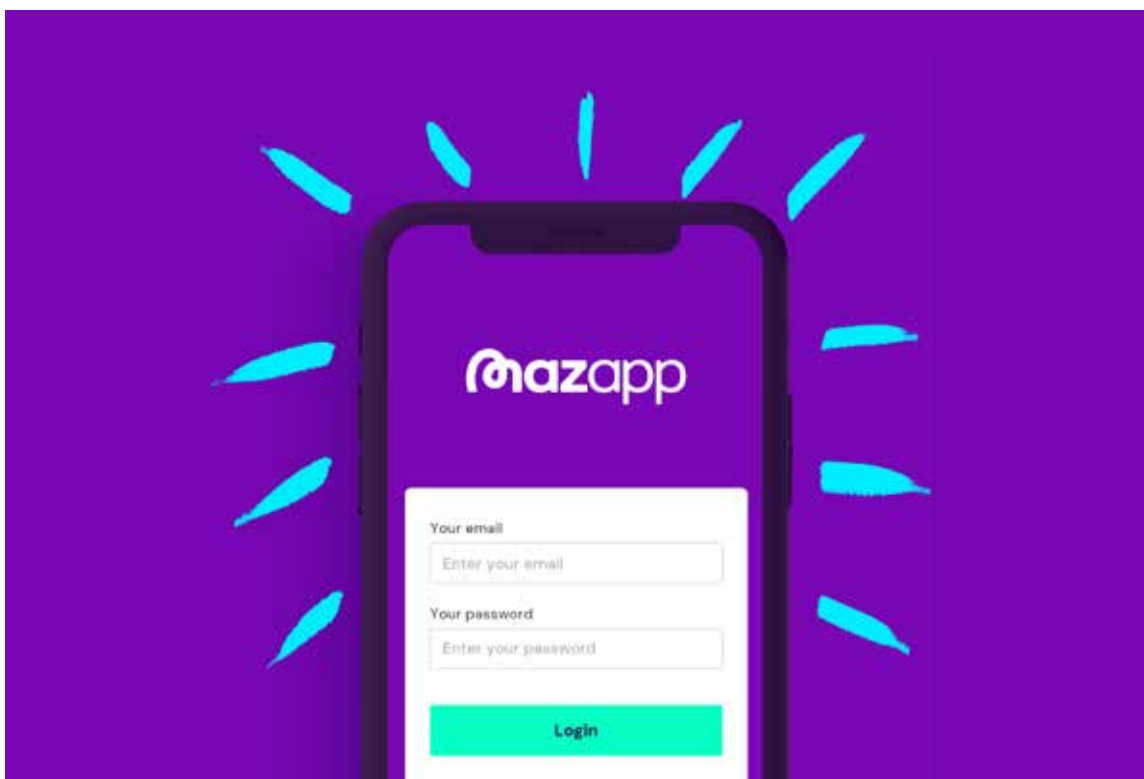
Accuracy

The digital systems required by Making Tax Digital ensure everything is calculated electronically, avoiding human error. As long as you log everything as and when it happens, you can sit back and relax while the software works its magic. Everything is accounted for using one system.

By avoiding mistakes, in theory, this should also mean fewer dealings with anything tricky from the folks at HMRC.

Making Tax Digital is happening, and there's no way around it.

Whether you opt to do it yourself with a HMRC-approved software, or by outsourcing your accounts to a reliable accounting company, Making Tax Digital provides an opportunity to simplify your finances, and regain some clarity and control of your accounts.





Accounting that works for you

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If you need to get in touch or want to speak to us, here are some details to help.

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