Making Tax Digital: Digital Links

Charity Tax Group Expert Insight Training Session with HMRC

25 February 2021   #mtddigitallinks

The voice of charities on Tax

Charity Tax Group: Digital Links

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Setting the scene

- VAT Notice 700/22, published on 18 July 2018, sets out the MTD VAT requirements for businesses, including digital links.

- MTD for VAT came in to effect on 1 April 2019 for businesses with taxable turnover on or above the VAT Registration Threshold.

- Soft landing period was introduced from 1 April 2019 to 31 March 2020 giving businesses space to adjust to digital links requirements. The soft landing period was extended to April 2021 as part of the Government measures to support businesses during the COVID crisis.

- Businesses now have until 1 April 2021 to meet MTD VAT digital link requirements.

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Digital links – what are they?

- Digital link is defined in the VAT Notice 700/22 Section 4 as:

…an electronic or digital transfer, or exchange of data, between software programs, products or applications.

- Section 4.2.1 also provides examples of digital links:
  - emailing a spreadsheet containing digital records so the information can be imported into another software product
  - transferring a set of digital records onto a portable device (for example, a pen drive, memory stick, flash drive) and physically giving this to someone else who then imports that data into their software
  - XML, CSV import and export, and download and upload of files
  - automated data transfer
  - API transfer

- Section 8 of the VAT Notice 700/22 shows examples of where a digital link is required.

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But….where does it begin?

- Functional compatible software is defined under para 4.2 of the VAT Notice as something that must be able to:
    - record and preserve digital records

    - provide to HMRC information and returns from data held in those digital records by using the API platform

    - receive information from HMRC using the API platform

- The digital link journey commences when information is input to the functional compatible software. The information from this point onwards is recognised as the 'digital record'.

HM Revenue & Customs

Next steps

- Businesses need to ensure that their MTD VAT functional compatible software products are digital-links-ready by 1 April 2021.

- Businesses looking to apply for a digital link deadline extension should email mtdspecificdirections@hmrc.gov.uk to request an application form with their business name and VAT Registration number. Applications will be accepted until 1 April 2021.

- MTD VAT will be extended to VAT registered businesses with taxable turnover below the VAT registration threshold from April 2022.

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Myth Busting

- Businesses must record invoices electronically under MTD VAT.

- HMRC can interrogate a businesses accounts via an API connection.

- EPOS must be connected electronically to the accounting system

- Software components must transfer all the detailed records from one product to another

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Questions

Demonstrating compliance to HMRC

What will HMRC expect to see during a compliance visit?

What happens if our digital links processes are not compliant?

After downloading data digitally from our accounting system into Excel, it's indistinguishable from data that's been typed in manually. **How might we be expected to prove that it's been downloaded digitally?**

There's no penalty for the Box 6 and Box 7 figures being wrong, so **is there any penalty for those figures not being derived using correct digital links**?

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Rationale for digital links – has it changed?

"**Digital links has been the most challenging part of MTD for us to comprehend**, partly because in the early days, there were different interpretations of the concept.

Initially, the purpose of digital links seemed to be to enable HMRC to track back, via the Charity's system, an entry in the VAT return to the source document (e.g. the invoice), effectively allowing them to **spot check VAT returns remotely**.

Now it seems that the **purpose is simply to avoid manual entries into the VAT return**, & to some degree, supporting documents, to remove the risk of a typing error.

It would be good to hear directly from HMRC the <u>rationale for digital links</u> and where it lies on the spectrum of the two extremes mentioned.

The concept gets muddied by emerging requirements in specific areas, for example, the level of analysis required from till system downloads."

Bridging Software

We plan to move away from our current bridging software solution, but it has recently come to light that we need to upgrade our general ledger system to a release version that includes the full MTD functionality.

That upgrade will require a project likely to last months, taking us beyond the deadline and we don't want to rush this.

Can you please confirm that bridging software is an acceptable on-going solution to HMRC ?"

Digital links and the digital journey

- "I've been unable to find a **definitive definition of what a digital link is - can HMRC clarify this**"

- "**If a set of transactions are downloaded from a separate system and then uploaded into the main accounting system, does this constitute a digital link?**"

- "**In what kind of scenarios would the digital journey begin prior to the stage of a transaction being present in the main accounting system? Or is the main accounting system always the first stage?**"

"Functional compatible software" and the start of the "digital journey"

"**Patrons book event tickets online** & the ticketing software records the details of each transaction. We generate **reports from the ticketing software** which we **import into Excel itemising** transactions by type and VAT treatment.

In Excel we use formulas to restructure the data from one worksheet to another, then we import it from the second worksheet into our finance software.

1. **Where does the digital journey begin**?

2. **Is the ticketing software considered part of our 'functional compatible software'?**

3. **If there is an error in the data exported from the ticketing software can we make a manual correction in the Excel worksheets?"**

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EPOS systems – daily gross takings

"Our EPOS system produces daily gross takings & VAT on the end of day printouts. These are typed into a spreadsheet for each trading day.

Currently I post these as one total monthly deposit into Quickbooks, giving the correct VAT and accounting entries. **For MTD would this pass the "digital" test?!"**

1. Upload each of the daily figures into Quickbooks as a .csv file each month

2. Calculate and manually adjust out total outputs that are "outside the scope" when I do the quarterly VAT return (leaving SR and ZR outputs in the Return figures). I can prove these numbers using different reports from our EPOS.

Permitted manual adjustments

- **What manual adjustments are permitted?**

- **Are partial exemption adjustments allowed?**

Reverse charge

"When invoices come in from an overseas supplier, the person coding the transaction in the accounting system would be unlikely to have the skill to determine whether or not the reverse charge would apply.

"These overseas invoices are therefore coded as "outside the scope" in our accounting software, which accurately reflects what is on the invoice.

"Where possible, these transactions would be reviewed during the period and a journal would be posted in-month to apply the reverse charge, so that the VAT entries flow through to the VAT return without manual intervention and to help ensure our management accounts are accurate where the VAT is deemed to be irrecoverable and therefore becomes a cost to the charity.

Reverse charge

"However, it is not always practical to fully review every invoice in-month for example where invoices are received late in the month, and so the reverse charge calculation may need to be performed during the VAT return preparation process instead. The reverse charge would then be treated as an "adjustment", similar to partial exemption adjustments.

"The MTD Notice could be interpreted as suggesting that the reverse charge is not like other adjustments, and instead that the self-supply must be recorded in the accounting software in the same way as if it were a normal supply.

"This suggests that if you *don't* record your reverse charge entries during the period, you would be correcting is as an 'error' during your VAT return preparation, rather than recording it as an accepted adjustment. Obviously we want to minimise instances of error, so this does not sit well with us.

Reverse charge

We believe that the reverse charge is a VAT adjustment, and is comparable to other types of self-supply. HMRC have previously said that deemed self-supplies arising from a change in use of a zero rated building, or deemed self-supplies of construction services, can be posted as 'adjustments' in the VAT return preparation process

We feel that the reverse charge should be treated as an adjustment in the same way.

Does HMRC agree with this interpretation?

EPOS – Manual entry and permitted adjustments

"**It would be so useful to clarify the principle of a permitted level of "manual" input when bringing data across from the source system**, in our case EPOS.

It would also be good to know **what adjustments are permitted when preparing VAT Return**.

HMRC officials have said that manually typing into a spreadsheet and then uploading digitally was ok, but this seems to be against the spirit of MTD and is not how the VAT notice appears to read – **can you clarify**?"

Posting manual journals

"I'm sure lots of organisations regularly post manual journals into their accounting systems.

"We have a small number of petty cash adjustments that I do as an adjusting entry in the finance system and would like to clarify if that is acceptable. This is done on a quarterly basis rather than posting all petty cash vouchers in this way."

How can these be compliant from a digital journey/digital links perspective, where these transactions are brought into the VAT return?

 Is HMRC expecting organisations to no longer use manual journals?"

Example of journals posted – self-billing invoice

"Sometimes we get sent self-billing invoices from our customers for royalties, where they send us a VAT invoice and the cash they owe us, including the output VAT. A management accountant will post a journal in our accounting software, which will include the value of the income and the value of the output VAT due to HMRC.

Can you confirm that entering a journal into the accounting system to record our VATable sales is ok under MTD? "

"And if, during the VAT return preparation process, it was found that the accountant had posted the journal incorrectly, **can you confirm it would be ok to treat this error as an 'adjustment' and correct it in our VAT return spreadsheet (which forms part of our functional compatible software)?**"

Digital links and donation databases

Data out of Raisers Edge (fundraising database) for the correction journals is reviewed by running queries to pick up data related to Trading VAT related transactions.

We currently then type the data into spreadsheet manually which is then uploaded into our Finance system via a '.csv' file.

Do we need to find a way to export the data in the queries and use formulae in the spreadsheet of downloaded data to prepare the upload spreadsheet for entry into our finance system?

Is the digital link tracking back beyond entry into the Finance system?

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Digital links & EPOS systems

How do digital links apply when we transfer sales data from our EPOS system to our account system. Or when we transfer data from our donation database?

The data is transferred by downloading the EPOS information to Excel, formatting the data into a format for upload to the accounts system (using lookups – no manual typing involved) , and then uploading the formatted sales information into the accounts system.

Is this process compliant with the digital link requirement?'

Digital links and online trading orders

- In relation to our online trading orders, we currently download reports from Paypal and Magento (which holds the online order information).

- We currently have some manipulation of this data before importing into Raisers Edge (fundraising database), some of which is copying and pasting. E.g. using a new tab to add the postage and packaging from the Paypal spreadsheet, then removing duplicate rows and then copying it back to the main spreadsheet page.

- **Is the data entering into our Finance system or our fundraising database the first point at which we need digital links and no copy/paste or does this have to go back as far as the website online orders data coming from Magento and Paypal?**