

EXPLANATORY MEMORANDUM TO

THE [VALUE ADDED TAX (AMENDMENT) REGULATIONS 2018]

[2018] No. [XXXX]

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument amends Part V – Accounting, Payment and Records of The Value Added Tax Regulations 1995 (S.I. 1995/2518) (“the VAT regulations”). It provides that VAT registered businesses must keep an electronic account (“the electronic account”) of information specified in the amended regulations and use an approved form of software (“functional compatible software”) to prepare and render returns. The regulations provide exemptions based on turnover, an inability to use electronic systems for religious or practical reasons and for businesses subject to insolvency but exempt businesses may opt for the obligations in the amended regulations to apply to them if they wish. The amended regulations also provide rules for how business records should be preserved.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 Paragraph 6(7) of Schedule 11 to the Value Added Tax Act 1994 (c.23) (“VATA”) provides that if regulations under paragraph 6(5) of that Schedule make provision requiring records to be kept or preserved in electronic form they must make provision for taxpayers to be exempt from that requirement if they fulfil the criteria specified in paragraph 6(7). This instrument provides that the electronic account is a designated record which must be preserved in electronic form, but it then also provides for the exemption required by paragraph 6(7) by making the precursor obligation to keep an electronic record subject to the exemption specified in that sub-paragraph. By operation of that exemption, no taxpayer who fulfils the criteria in paragraph 6(7) can be required to preserve an electronic account in an electronic form.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 Schedule 11 to VATA provides vires to make regulations about the administration of VAT. Part 5 of the VAT regulations provides rules about accounting, payment and records. They already provide that businesses should use an electronic return system unless they fall into one of the specified exemptions.

- 4.2 This instrument, as well as relying on existing vires in section 135 of the Finance Act 2002 (c.23), also relies on vires in paragraphs 2 and 6 (“paragraph 6”) of Schedule 11 to VATA as amended by section 62 of the Finance (No.2) Act 2017 (“section 62”). This instrument represents a first use of those amended vires.
- 4.3 Prior to amendment paragraph 6 imposed an obligation on taxpayers to keep records which are specified by the Commissioners in regulations and also provided that the duty under paragraph 6(4) to preserve the records may be discharged by preserving them, or the information in them, in any form and by any means.
- 4.4 Section 62(3) amends paragraph 6 to insert new sub-paragraphs (5) to (11). New sub-paragraph (5) (“sub-paragraph (5)”) permits the Commissioners to make regulations about the form in which and the means by which the required records must be kept. New sub-paragraph (7) requires the Commissioners, if they make regulations which require the records to be kept in electronic form, to also make provision for a taxpayer to be exempt from that requirement if for any month (“the current month”) the value of that taxpayer’s taxable supplies in the year ending with the month before the current month was less than the VAT threshold. New sub-paragraph (9) defines the VAT threshold as the amount specified in paragraph 1(1)(a) of Schedule 1 to VATA (the threshold for compulsory VAT registration) on the first day of the current month.
- 4.5 Section 62(3)(a) provides that paragraph 6(4) (the statutory provision regarding preservation of records) is to be omitted and section 62(4) amends paragraph 6A of Schedule 11 (power to make specific directions regarding records) so that regulations under sub-paragraph (5) will apply for the purposes of that paragraph as they apply for the purposes of paragraph 6. Section 62(7) provides that subsections (3)(a) and (4) of that section will come into force only when the first regulations under sub-paragraph (5) come into force. This instrument will therefore bring those subsections into force. Section 62(7) prohibits regulations under sub-paragraph (5) from making provision requiring records to be kept or preserved in electronic form which has effect before 1st April 2019.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

- 6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

- 7.1 The Government recognises that businesses want to get their tax right, but many businesses find this hard to do. For example, the difference (between total taxes owed to the government and taxes paid on time also called the tax gap) is estimated at £34 billion¹ of which £9.4bn is due to error and failure to take reasonable care.
- 7.2 The Making Tax Digital programme aims to help reduce the tax gap and bring the tax system into line with what businesses and individuals expect from other online services

providers: a modern digital experience. This will in time extend to other taxes in addition to VAT.

- 7.3 The Government announced on 13 July 2017 that, for the time being, only businesses above the VAT registration threshold will participate in Making Tax Digital from 1 April 2019.
- 7.4 This instrument will require businesses to keep and preserve digital records and use functional compatible software, which by definition is capable of recording information, sending information and receiving it from HMRC.
- 7.5 To complete a VAT Return, businesses will use information stored in their digital (electronic) records. This VAT information will then be sent directly to HM Revenue and Customs (HMRC) to complete the 9 box VAT Return form.
- 7.6 It is anticipated that this will make it easier for businesses to get their tax right the first time. It will also reduce the costs, risk of errors and worry that businesses face when HMRC intervenes to put things right. Businesses will not need to adjust their VAT reporting dates or be required to provide any more VAT information than they do already.
- 7.7 These obligations will not apply to businesses if their VAT taxable turnover for the previous 12 months is below the VAT registration threshold in force at the start of the next month. Once the threshold is exceeded, the obligations will commence from the business's next return period. However, once any business is caught by these regulations, then even if the business's VAT taxable turnover subsequently falls below the exemption threshold they will still be obliged to keep and preserve digital records and provide VAT returns using functional compatible software unless and until they deregister from VAT.
- 7.8 There are other exemptions to these requirements on the grounds of a taxpayer's religious beliefs, practical inability to use a functional compatible software system or when subject to insolvency procedures.
- 7.9 HMRC is not supplying businesses with any VAT software but has been working with developers to help them design functional compatible software.

Consolidation

- 7.10 There are no plans to consolidate the VAT Regulations.

8. Consultation outcome

- 8.1 In August 2016 the government published 6 consultations documents. The particular consultation relevant to this Statutory Instrument was called 'Bringing business tax in to the digital age'ⁱⁱ. HMRC received 618 written responses from individuals (including businesses) (153), accountants (264), representative bodies (40) and others (161). The consultation response was published in January 2017ⁱⁱⁱ.
- 8.2 Most respondents supported the direction of travel of the Making Tax Digital proposals but many raised concerns about the timetable, adjusting to digital change, burdens, data security, and agents' accessing digital services to support their clients. The government has responded to these concerns by adjusting the rollout timetable (see section 7.3 above).
- 8.3 In September 2017, a VAT Legislation Overview^{iv} was published for consultation. The consultation closed on 10 November 2017 and HMRC received 43 responses

from accountancy bodies, large and small businesses and other professional organisations.

9. Guidance

- 9.1 [VAT Notice XX: Making Tax Digital for VAT] sets out information that supports this instrument.

10. Impact

- 10.1 Making Tax Digital builds on HMRC's existing digital services for businesses, including the business digital tax account that is already available to all 5.4 million small businesses.
- 10.2 Public sector benefits will be mainly realised through the reduction in the tax gap and the improved and modernised experience that a fully digital HMRC will offer to business customers.
- 10.3 A Tax Information and Impact Note (TIIN) for Making Tax Digital for Business was published at Spring Budget 2017. An updated statement of impacts was published at Autumn Budget and is available on the gov.uk website^v.

11. Regulating small business

- 11.1 This instrument applies to activities that are undertaken by small businesses, subject to the exemption for the smallest businesses with taxable turnover below the VAT registration threshold described in section 2.3 above.
- 11.2 Making Tax Digital will improve the quality of record keeping, reducing the likelihood of mistakes (and attendant risk of unwelcome and costly HMRC compliance interventions) and help businesses to manage their cash flow more effectively.
- 11.3 HMRC has engaged extensively with all sectors affected by the changes, and will ensure there is software and support in place that meets their needs and is testing the processes extensively.

12. Monitoring & review

- 12.1 HMRC will monitor the impact of the changes introduced by this instrument on an ongoing basis using information collected from its internal systems and processes, as well as regular engagement with affected stakeholder groups.

13. Contact

- 13.1 Kamran Quadri at HM Revenue and Customs, Telephone: 03000 524463 or email: kamran.quadri@hmrc.gsi.gov.uk, can answer any queries regarding the instrument.

ⁱ Measuring tax gaps 2017 edition – Tax gap estimates for 2015-16 released 26 October 2017
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655097/HMRC-measuring-tax-gaps-2017.pdf

ⁱⁱ Bringing business tax in to the digital age consultation published 15 August 2016
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/545715/Making_Tax_Digital-Bringing_business_tax_into_the_digital_age-consultation.pdf

ⁱⁱⁱ Bringing business tax in to the digital age – Government response published 31 January 2017
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf

^{iv} Making Tax Digital for VAT: legislation overview consultation published 13 September 2017
<https://www.gov.uk/government/consultations/making-tax-digital-reforms-affecting-businesses/making-tax-digital-for-vat-legislation-overview>

^v Making Tax Digital: changing the scope and pace - technical note:
<https://www.gov.uk/government/publications/making-tax-digital-changing-the-scope-and-pace-technical-note>

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