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MTD for VAT

Exploring the barriers and enablers to becoming
compliant

Ipsos MORI
June 2020

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Glossary of Terms

Application Programming Interface (API):

The mechanism by which VAT data held in software is submitted to HMRC systems.

Bridging software:

An additional software programme that takes data from another piece of software (e.g. a spreadsheet or legacy software) in a format that enables the VAT return to be submitted to HMRC via an API. It does not deal with any of the other requirements of MTD for VAT such as digital record-keeping. Some bridging software is free of charge, some free for a limited period of time, some charge by use, others charge a monthly subscription or license fee.

Digital link:

A means by which the electronic transfer or exchange of data between or within software programmes, products or applications is achieved.

'Old' HMRC VAT Portal:

Prior to MTD, businesses used to submit their VAT returns to HMRC by manually typing information into an online portal. Those businesses that have not yet signed up to MTD can still submit their VAT return information using this VAT Portal.

Legacy software:

Accounting software packages, often downloaded onto computers and systems, which predate MTD for VAT and so do not provide access to the MTD API platform.

Light touch period:

HMRC acknowledges that businesses may encounter problems complying with their new MTD obligations. Where businesses are doing their best to comply, a proportionate 'light touch' approach to record-keeping penalties has been taken. This means that HMRC has not pursued record-keeping penalties in the first year of MTD mandation. This light touch only applied to record-keeping penalties and only where businesses made a genuine effort to comply with the MTD requirements. There is no equivalent light touch period for late payment or filing penalties.

Making Tax Digital for VAT (MTD for VAT):

Making Tax Digital (MTD) for VAT is the strategy through which HMRC aims to transform the tax system. It requires VAT registered businesses with a taxable turnover above the VAT registration threshold to keep records in digital form and file their VAT returns using software.

MTD for VAT compliant business:

For a business to be MTD compliant it must keep business records in digital form and file VAT returns using MTD compatible software. MTD compatible software submits a business' VAT return directly to the MTD API platform.

Third-party (commercial) software (for VAT):

Commercial software products which fully meet MTD for VAT requirements for digital record-keeping, digital links and submission to the MTD API platform.

Transferring spreadsheet data:

The act of moving or uploading data saved in spreadsheet format from the business's device or network drives onto the additional (bridging) software used solely to make MTD compliant submissions. This is a separate process which happens before the additional (bridging) software submits the data to HMRC via the MTD API platform.

Executive Summary

Background and Context

As of April 2019, the vast majority of businesses registered for VAT, that have a taxable turnover above the threshold level of £85,000, are required to keep digital VAT business records and send returns using Making Tax Digital (MTD) compatible software. MTD makes it easier for businesses to get their tax right. As businesses become increasingly digital, the use of digital record-keeping tools helps prevent businesses from making errors. This addresses the part of the tax gap that is attributable to error and failure to take reasonable care by significantly reducing the opportunity to make some types of mistake in tax returns, principally simple arithmetical and transposition errors. At the point of conducting this research in March 2020 around 16% of businesses mandated to comply with MTD obligations from April 2019 had not done so. It was clear that HMRC would benefit from further exploration into the reasons behind non-compliance and the key enablers that could encourage compliance. In addition, messaging around enforcement and penalties required testing to understand the type of messaging that could encourage non-compliant businesses to sign up to MTD for VAT.

HMRC commissioned qualitative research consisting of 44 telephone interviews with mandated businesses who had not yet signed up to MTD for VAT to:

- Gain a deeper understanding of the reasons and motivations behind non-compliance
- Explore barriers and enablers to support businesses in becoming compliant
- Develop more compelling communications when mandating businesses

Motivations behind and barriers to non-compliance

Lack of knowledge, information and skills were frequent barriers to MTD compliance. The **vast majority of businesses involved in the research were keen to comply with MTD for VAT and were** often putting in considerable effort to comply, however they had come up against gaps in their knowledge and / or skills or lacked key pieces of information needed to continue with their compliance journey. There appeared to be several factors driving the gaps in knowledge and skills, including:

- **Misunderstanding of the term ‘digital’ and ‘digital links’.** To many, digital in this context (MTD) could be understood simply as online, or even just ‘not on paper’. This often led to an incorrect assumption amongst businesses that they were compliant, when in fact they had misunderstood what it meant to be compliant.

- **Struggling to operate MTD compliant software.** This was a cause of real frustration, as they had made the effort to install new systems but were not able to operate them effectively and could not find sufficient help anywhere.
- **Fear of the unknown:** There were businesses who had not even considered new MTD compliant software. These businesses feared transitioning from their current systems to new systems would mean a long adjustment period and would mean losing processes that suited their businesses perfectly.
- **Just need one more piece of information:** Some businesses felt they were just missing one final key piece of information, which once obtained would enable them to sign up to MTD straight away. An example of a key piece of information missing for a business was whether an individual running several smaller businesses should sign up to MTD as a group.

Some businesses **lacked a sense of urgency towards becoming MTD compliant**, which made it easier to ‘put it off to the last minute’. The accountants of some businesses played an active role in encouraging this complacency, suggesting that it would be **best to put off compliance right until the last minute or wait until HMRC offered their own solution** as they did with PAYE. This was often compounded by a **lack of clarity or awareness around the HMRC deadlines** within businesses, with some completely unaware that penalties might start to be charged if non-compliance persisted beyond April 2020 or believing that April 2020 was the start of the ‘light touch’ period. Some businesses had everything in place to become compliant but **just needed to complete one final step**, this lack in motivation to complete the final step was most often a case of no one in the business prioritising signing up, there were no barriers facing these businesses that were outside of their control.

Factors associated with non-compliance were the perceived or actual **time and financial costs** associated with being MTD compliant. **Subscription fees of new MTD compliant software**, and / or the need to invest in **updating their servers and systems to accommodate new software** were additional costs businesses were reluctant to absorb. Some businesses **lacked awareness of cheaper and simpler software solutions** and assumed they had to factor in substantial costs for wholesale changes to MTD compliant software. There was also an assumption that becoming MTD compliant was a lengthy task and would **divert time away from more business-critical priorities**.

A few businesses were **encountering unforeseen barriers** or situations outside of their control. **Illness** within a small business could mean critical staff shortages and delay MTD compliance. **Poor broadband** connection was a very real issue for businesses in remote areas and could make any computer-based actions a very lengthy or even impossible task. Lastly,

there were those who encountered **technical issues with the HMRC website** when they tried to make their first MTD submission.

Reactions and responses to HMRC messaging and communications

Statements from a reminder letter and email HMRC sent out to non-compliant businesses between July 2019 and February 2020, were read out during interviews to gauge recall of the letters and emails, and to explore reactions to what these reminders communicated. Recall of the letter and its content was low amongst businesses. Many could not recall receiving a letter or email at all, and those who could struggled to remember its contents. Through exploring reactions to the message statements, it became clear that reactions fell into two groups. There were those who felt that the statements would inspire no action, and in fact they might feel sceptical towards it. This scepticism was motivated by a feeling that the messages were quite generic and lacked personalisation. It would therefore be easy to ignore them and assume that their contents did not apply to their business. This was particularly true when businesses had misunderstood the term 'digital' and what was required to be compliant. Secondly, there were those for whom statements from the reminder letter / email would cause severe stress. These businesses were actively trying to comply but were coming up against barriers such as a lack of knowledge. They wanted some sort of acknowledgement from HMRC that they knew their business was making an effort to comply.

New message statements were also explored in the interviews. Each statement's tone, call to action and communication was explored with businesses. Similarly, to the reminder letter, two reactions emerged. Firstly, there were those more complacent businesses who felt that the messages needed to be less vague and ambiguous and convey a firmer more direct message. A lack of urgency was often a significant barrier for businesses who reacted to the new messaging in this way. By contrast, there were businesses who found the messaging too harsh and punitive. They wanted HMRC to offer and signpost more help and support. While they appreciated that there needed to be penalties for not complying, they felt it would be unfair to completely disregard any efforts businesses might be making to comply. Businesses that reacted in this way tended to be encountering barriers around lack of knowledge and were taking steps already to comply.

Considerations for supporting businesses in becoming compliant

Most of the businesses interviewed were trying to comply with MTD for VAT, others on the other hand lacked urgency. Those who were trying encountered a variety of barriers and wanted further support from HMRC or software providers to overcome these.

- Businesses lacked a clear understanding of the reasons driving the MTD for VAT policy and were unaware of any potential benefits for them in signing up to MTD. **Improving general awareness and understanding of MTD** could increase the motivation of non-compliant businesses to comply.

- There was a general misunderstanding of what being MTD compliant meant with many being confused by the term 'digital' or 'digital links', leaving some businesses surprised that they were not compliant. **Greater clarity around the term 'digital', 'digital links' and MTD compliance** will be essential in educating all business, but particularly those who believe they are already compliant, but in fact are non-compliant. The lack of certainty became clear early in the project, as several businesses in the sample were prompted by the recruitment letter we sent out to check their status and take action to comply.
- Migrating to MTD compatible systems was perceived as a big and complex task with many businesses lacking awareness of the range of software solutions available to them. **Sharing examples of similar businesses who had transitioned successfully** to becoming MTD compliant could improve awareness and change perceptions.

The use of language within **key messages and statements needs to be more direct** and less rooted in what could *potentially* happen to avoid confusion and mitigate the risk of businesses not taking the messages seriously enough or ignoring the messages altogether. However, this approach must be moderated and accompanied by the provision of and signposting to support and help mechanisms from both HMRC and third-party software providers. This is particularly important in order to speak effectively to those encountering barriers but trying to comply, as well as providing an effective call to action to businesses who are more complacent or lack urgency in becoming compliant.

1. Introduction

1.1 Background & Context

As of April 2019, the vast majority of businesses registered for VAT that have a taxable turnover above the threshold level of £85,000 are required to keep digital VAT business records and submit returns using Making Tax Digital (MTD) compatible software. MTD makes it easier for businesses to get their tax right. As businesses become increasingly digital, the use of digital record-keeping tools helps prevent businesses from making errors. This addresses the part of the tax gap that is attributable to error and failure to take reasonable care by significantly reducing the opportunity to make some types of mistake in tax returns, principally simple arithmetical and transposition errors.

At the point of conducting this research in March 2020 around 16% of businesses mandated to comply with MTD obligations from April 2019 had not done so. While the reasons for non-compliance were still unclear, several factors had emerged from earlier research, including security concerns, financial barriers and the additional time needed to get used to new software. Previous research¹ also suggested that around five percent of businesses maintained an exclusively paper-based record-keeping system, meaning that these businesses might lack the confidence and capabilities in using the internet or software more generally.² However, awareness of MTD was generally found to be high and the use of software or spreadsheets reasonably widespread – so those traditional ‘justifications’ for non-compliance did not necessarily apply. It was clear that the reasons behind non-compliance and the key enablers that could encourage compliance required further exploration. In addition, messaging around enforcement and penalties needed to be tested to understand the type of messaging that could encourage non-compliant businesses to sign up to MTD for VAT.

1.2 Research aims and objectives

This research was commissioned to gain a deeper understanding of the reasons and motivations behind non-compliance, explore the key barriers and enablers in becoming compliant, and develop effective messages that would encourage and compel businesses to become MTD compliant. To answer these overarching research aims, the following research questions were addressed:

- What are the motivations behind non-compliance? And in what context?
- What are the barriers to complying with MTD?
- What are the enablers that can encourage compliance?

¹ “Making Tax Digital’ – Monitoring Business’ Awareness of MTD- Updated.’, Ipsos MORI, March 2020

² ‘Evaluating Making Tax Digital’s impact on record-keeping behaviour and scope for error among small businesses.’, Ipsos MORI, March 2020

- How can HMRC develop compelling messaging for mandated businesses to comply?

1.3 Methodology

Qualitative research was used to detail key reasons for non-compliance, explore barriers and enablers to support compliance, and identify effective messaging to support businesses to sign up to MTD and use MTD compatible software.³ A total of 44 telephone interviews were carried out by members of the Ipsos MORI research team with mandated businesses who either were not yet using MTD compatible software and / or signed up to MTD and therefore were non-compliant, or were compliant but had only very recently signed up. Fieldwork took place between 21st February and 20th March 2020. Each interview lasted approximately 45 minutes in length. Businesses were recruited from two sources: 34 participants were recruited from a sample of non-compliant MTD mandated businesses provided by HMRC, and 10 through free-find recruitment. Businesses were recruited using purposive sampling. Key criteria were set and participants were recruited according to these using a screener to ensure different types of businesses were reflected in the sample. The sample achieved was as follows:

Sample criteria	Sample sub-categories	44 Telephone interviews
Business size	Sole (Zero employees)	9
	Micro (1-9 employees)	31
	Small (10-49 employees)	4
Existing record-keeping method	Paper (predominantly)	6
	Spreadsheet	13
	Software	25
Recently signed up to MTD for VAT	No – not yet	38
	Yes – very recently (1/2 submissions at most)	8
Annual turnover	£195k+	12
	Between £85k - £195k	31
	Less than £85k (but turnover may have exceeded £85k in the past)	1
Digital confidence	Digitally confident when doing tax online	26
	Lacks digital confidence when doing tax online	18
Confidence approaching VAT	High	29
	Low	15

Secondary quotas were also set on: number of years trading, sector, region, business type, and type of payments received.

³ This approach relied on detailed discussions over the telephone with a sample size of 44 participants, so it should not be read as statistically significant.

2. Technology and bookkeeping confidence

This section provides a qualitative overview of the overall levels of confidence the businesses involved in this research had in bookkeeping and using digital technology.

2.1 Overall confidence in using technology and bookkeeping

Overall, most businesses felt confident using digital technology, but confidence was generally limited to using technology they were most familiar with or used daily, both at home and in work. However, bookkeeping confidence was much more varied. While businesses were generally happy with and confident in their current processes and systems for filing their VAT returns, they felt far less confident in migrating to an MTD compliant system. Most felt uneasy at the prospect of change and were daunted at the thought of moving away from their 'tried and tested' systems to something new. Some businesses had reservations and questions around whether the new MTD compatible systems would be fit for their business and fully meet their needs as they felt their businesses had niche requirements that third-party accounting software would fail to meet.

"I'm pretty savvy with technology. Not like the kids nowadays but I'm pretty savvy for my age."

Micro Business, Wholesale and retail trade, Midlands

"I'm not a techno person. However... once I know what I'm doing, I'm absolutely fine."

Micro Business, Manufacturing, Midlands

"I know what I need to know... I do what I need to do. I gradually learn things."

Micro Business, Motor vehicle repair, East of England

"[MTD] it's putting pressure on me to do something that I don't know how to do and I can't find anybody who can help me how to do it."

Micro Business, Retail, North West

"I just stick with what I know, I stick with what's easy."

Micro business, Retail, South West

3. Motivations behind and reasons for non-compliance

This chapter presents four overarching motivations behind and reasons for MTD non-compliance that emerged from this research. Each of the motivations and reasons are presented in turn with core factors and underlying issues driving the motivations and reasons being explored.

3.1 Lack of knowledge, information and skills

The vast majority of businesses involved in the research were keen to comply with MTD for VAT. However, these businesses were generally inhibited or hampered by a lack of knowledge, information and skills linked to four key factors or underlying issues:

- A misunderstanding or misperception of the concept 'digital',
- Unable to use or work the MTD compliant software,
- Missing one piece of key information or step to becoming compliant, and;
- A reluctance to move to the unknown.

3.1.1 A misunderstanding or misperception of the concept 'digital'

Several businesses believed they were already MTD compliant, but through the course of the research realised they were non-compliant which left them somewhat surprised. This confusion was a result of a general misunderstanding or misperception of the concept of 'digital'. Most understood digital to mean submitting their VAT return online (using the 'old' HMRC Portal), or even to mean simply 'not on paper'. This misunderstanding was further compounded by the fact businesses could still input their figures manually and submit their VAT returns through the 'old' HMRC portal. There was a general sense amongst these businesses that 'digital' was too vague leaving many of them confused and unsure as to whether they were fully compliant or not. This finding was consistent across businesses regardless of their levels of confidence in using technology, suggesting that a clearer definition of what being MTD compliant means is needed.

Case Study - Sole Trader, Electrical Company, Yorkshire

He has run his own company for the last 8 years and feels very confident using technology, as his previous job was overseeing the installation of large computer servers for financial companies. He has always used [software provider] to make his submissions and is proud that he does things online rather than on paper. He still however makes the final input by hand so is non-compliant. He believes that because his accounts are all done on the computer, and there is no cash in hand, he is compliant. He thought that MTD was put in place to catch out businesses that take cash in hand and don't pay their taxes - he is aware of many of these types of companies in his industry.

“As far as I’m concerned, I’m 90% there anyway. I don’t do paper returns, I’m doing it on a [software] spreadsheet. We send all the information on the HMRC Paying VAT Online, so we do all that. As far as I’m concerned that’s pretty much there. I don’t know what else they want.”

Micro business, Retail, South West

“I saw the letter for it [MTD for VAT], I checked the list of software and thought great we have [software provider] so I am doing it already. I didn’t realise I wasn’t compliant and need to sign up for it with [software provider] and HMRC for the systems to link as far as I was concerned I was ‘digital!’”

Micro business, Professional, scientific and technical activities, London

“I thought ‘well we are digital’. I go on the computer, I go on to the HMRC Gateway and I claim for my VAT and I press send. That’s sending it digitally, isn’t it?”

Sole trader, Manufacturing, West Midlands

3.1.2 Unable to use or work the MTD compliant software⁴

These businesses had in fact invested time and money into MTD compliant software but were struggling to use the software, leaving businesses frustrated that despite purchasing a compatible system, they were still MTD non-compliant. While these businesses suggested they felt digitally confident, this confidence was generally confined to the systems and processes they felt most comfortable with and used on a daily basis. This meant the prospect of changing their processes and migrating from their ‘trusted-approach’ to a new system with slightly different or more technical bookkeeping terminology posed a significant technological challenge, surpassing what they were confident doing. Although businesses were aware that learning how to use a new system was time consuming, the lack of improvement in their skills and ability to use the system left many feeling demotivated and disheartened. This was further compounded by the perception and belief that the help and support offered by some of the software providers was not extensive enough or inadequate. The prospect of not being able to use their MTD compliant software by April 2020 and the assumption that this inability to comply with MTD for VAT could potentially result in some kind of penalty added a level of stress and concern for these businesses.

⁴ Parallel and complementary findings emerged in a previous study around usability and competence. See [‘Evaluating Making Tax Digital’s impact on record-keeping behaviour and scope for error among small businesses.’, Ipsos MORI, March 2020](#)

Case Study - Micro Business, Manufacturing, Northwest

She runs every part of the back-office operation. Late last year her accountant recommended her business switch to software provider A. She had earlier in the month experimented with software provider B, which she really got on well with, however her accountant was not offering a deal on software provider B so she subscribed to software provider A. Since then she still has not been able to work out how to use software provider A and is now getting desperate. She has not found any useful software provider A training and feels she is quickly running out of options. She is annoyed she didn't explore other MTD compliant options more, but her accountant made her rush into a software provider A subscription.

"One of the main issues we had was that of our data in software provider A wasn't compatible with software provider B. We've had to do a lot of work to make it compatible. That's been one of the biggest issues. It's just learning the new software and understanding how it works."

Sole trader, Web Design, Scotland

"I seem to be in limbo when it comes to this between HMRC and software provider A... I get to a page within software provider A where it states there's no authority granted and therefore go to the HMRC site. I've done that, selected grant authority but I'm going through this circle of granting authority and software provider A doesn't seem to recognise that."

Micro business, Health and Safety, East of England

"I'm inputting data into it and I don't know that I'm doing it right or not, so I want to just try and clarify everything before I go any further."

Micro business, Sport, North East

3.1.3 Missing one piece of key information or step to becoming compliant

These businesses were almost compliant but required one final piece of information or needed to complete one final step. For some, the information required to comply was quite specific to their business, while for other businesses the steps required for compliance were much more general (e.g. the need to link their software with the new HMRC MTD API platform, or the need to sign up to MTD for VAT). The complexity of the information or the size of the step businesses needed to take varied, with some much closer to compliance than others. However, there was a sense amongst these businesses that the time and resource required to becoming MTD compliant would be reasonably minimal. Although there was little understanding of the exact amount of time it would take to complete some of the tasks, they were generally perceived to be straightforward. For example, many businesses believed that connecting their software to the new HMRC MTD API platform would be an immediate process.

Case Study - Small Business, Real Estate, South West

The business she works for looks after several small individual companies in different locations around the South West. All the individual companies have technically been MTD compliant (using bridging software) since October last year. However, she is currently trying to find out whether she needs to register the group companies individually for MTD and do individual returns, or whether she can do a group registration & group return. She couldn't find an answer online, so she has been calling HMRC to try and find out.

"I've yet to really understand whether I've got to keep everything digital or whether I can still use my book [ledger]. And that's why I haven't done it yet as I don't really understand whether I can keep using my book, or whether I've got to get everything digital."

Micro business, Kitchen fitter and supplier, East of England

3.1.4 A reluctance to move to the unknown⁵

MTD for VAT could represent an unwanted change or migration from businesses' 'tried and tested' processes to a new and unfamiliar system that required different processes and, potentially, negative consequences. For many, the prospect of change creates a sense of uncertainty, and a fear that the accuracy of their VAT returns might be compromised. Several businesses felt they were being made to move away from bookkeeping systems that not only worked well, but were also well suited to their business needs, which caused concern. For some, moving their financial details to an online cloud-based system raised fears of their systems being hacked which may compromise their data security. Others felt that transitioning to a more automated approach might lead to future job losses. More generally, the understanding of why MTD for VAT was rolled out was low. Very few businesses saw any potential longer-term benefits to themselves, with the most tangible benefit being the avoidance of a penalty for non-compliance. This lack of understanding of the potential benefits to migrating to an MTD compatible system made it less palatable for businesses to transition from their familiar and trusted systems to new software that tended to cost more than their existing systems and would initially take time to get used to.

⁵ Parallel and complementary findings emerged in a previous study, specifically in the 'Bridging Software' section. See '[Evaluating Making Tax Digital's impact on record-keeping behaviour and scope for error among small businesses.](#)', Ipsos MORI, March 2020

Case Study - Sole trader, Energy Consultancy, Yorkshire

For all of his finances, he uses a spreadsheet that he designed himself. He is aware of accountancy software but feels this would not meet the needs of his business as well as his spreadsheet does and will take a lot of time to change over to and become familiar with. He is doubtful that new software would be worth the cost or time and does not see any benefits to his business.

"I had one particular buyer, I had to pay two commissions, which is quite easy to do in this manual spreadsheet, but if I had some accounting software, I'm fairly certain it wouldn't cater for those intricacies, so I just find it easier to work it out."

Sole Trader, Energy Consultancy, Yorkshire & Humber

"The thing that bothered me the most was having to change my software, or change what I was doing, just to submit it. Basically, I thought 'why should I? Why should I have to do that?'"

Micro Business, Manufacturing, Northwest

"I'm thinking, 'Hang on a minute, I've got 15 years' worth of personal information here, as much as you're my software provider do you think I'm going to let you store it online for someone or anyone who has a fancy can look at it?'"

Sole trader, Electrical Company, Yorkshire & Humber

3.2 Lack of urgency

An important underlying motivation to MTD non-compliance was a lack of urgency to change. There was a sense amongst some businesses that 'everything will be fine', and that MTD was not, at that time, a priority for the business. This feeling stemmed from three factors or issues:

- Encouraged by their accountant to delay becoming compliant
- Lack of clarity around sign up and deadlines relating to the first filing deadline and the 'light touch' approach to penalties
- Everything is in place, but need to sign up to MTD and make their first submission

3.2.1 Encouraged by their accountant to delay becoming compliant

With some businesses, accountants have played a significant role in their non-compliance with MTD. Small businesses appeared to rely very heavily on the advice of their accountant, and rarely probed their accountants further as they were seen as the 'experts' and being paid to advise businesses. When businesses were told by their accountant to 'put off compliance', they were happy to take their advice at face value. Reasons offered by accountants as to why businesses should 'put off compliance' were varied. Accountants told some businesses that there was no imminent deadline for MTD compliance, and that there was no need to hurry at all.

Other businesses were advised to wait until the last minute to comply as this would be more beneficial for them, as it would increase the chances that HMRC provide their own solution, as they did with PAYE. This would therefore mean businesses could, if what accountants were saying was true, avoid having to select, sign up to and pay for new MTD software with limited help or support. Finally, some accountants advised against compliance with MTD until absolutely necessary because compliance would mean they could not submit their VAT the 'old way' anymore. Manually inputting into the VAT returns form through the 'old' HMRC portal was perceived to be less hassle for businesses and should be continued to be used for as long as possible, delaying MTD compliance.

"I rang him [accountant] up, sort of like panicking, thinking I'll have to go tax digital cos I'm frightened I'm going to be over the 85. And he said 'yes, you will have to but there's no panic at the moment'. He's not saying I didn't have to, he's just saying that there's no need to do it straightaway."

Micro Business, Sport Equipment Installation, North East

"The advice my accountant gave to us was to leave it until you don't have a choice and there'll probably be an alternative by then... Just hold on tight, I've got a lot of people in the same boat."

Micro Business, Financial Software Company, Midlands

"He said to me 'if you don't sign up for it you can still use the old system'...I haven't signed up and the old system is still available for me to get into."

Micro Business, Car Repair, East of England

3.2.2 Lack of clarity around the HMRC deadlines

Not all businesses were clear on when they would need to be fully compliant to avoid penalties. Those who had not engaged with any communications from HMRC were completely unaware that they had missed MTD deadlines and could become subject to penalties. The fact that they could still submit their return using the 'old' HMRC portal and the lack of prompts from their accountants added to the sense that there was no upcoming or pending deadline. Although some businesses were well aware that the 'light touch' approach to penalties was ending soon, confusion still remained for others with one business being under the impression they had over 12 months to address this.

"I haven't had time to explore what MTD is exactly, is there a deadline coming up?"

Micro business, Retail, North East

Case Study – Micro Business, Real Estate, South West

He has run his own business for nearly 20 years. He has always submitted his return using [spreadsheet software] and remembers when there was a tax office to visit where you received personalised service. He could not remember hearing anything anywhere about MTD and was surprised his accountant had not told him. He assumed all was well as he was still able to submit online.

3.2.3 Everything is in place, they just need to sign up to MTD

Several businesses were at the end of their compliance journey, and only had one final step to make to be fully compliant – signing up to MTD to make their first digital submission using their MTD compliant software. There were three reasons given as to why this final stage had not been completed. Firstly, leaving it until the last minute. These businesses were not ‘panicked’ by MTD, as they knew they were very close to compliance, so were comfortable leaving it right until the ‘eleventh hour’. Secondly, there were those who just had one small task to complete before they could sign up. These businesses were confident in how straightforward this final task was to complete, and so were happy to put it off until they were close to the deadline. And thirdly, there were those who kept forgetting each time they submitted a return to sign up to MTD and make MTD compliant submissions. For many businesses, submitting their tax return is the last thing they do for the day, and they often don’t leave much time to do it. As submitting returns can therefore be quite hurried, it is easy for businesses to forget to finalise the last step necessary to comply. The few businesses who had just become MTD compliant discussed how they had assumed that because it was now digital it would happen automatically and that they had not checked to see if the rules regarding the ‘old’ submission deadlines had changed.

Case Study - Micro Business, Construction, Yorkshire

She moved to [software provider] from [spreadsheet provider] a year ago and is very happy with it. She also recently moved from being a sole trader to being a micro-business. She has still got to re-register her status with HMRC. Once that comes through she will then be able to sign up to MTD.

Case study - Micro Business, Media Consultancy, Midlands

He has been set up on [software provider] for the past 6 months. He has always left submitting his taxes to the last minute – “it’s how I do everything”. Signing up to MTD must be done seven days before the submission deadline, so he hasn’t yet made his first MTD compliant submission.

3.3 Time and Cost

Businesses involved in the research felt like they were very stretched – from both a time and financial perspective. The perceived and actual time and costs associated with signing up to MTD were therefore major barriers. Barriers that fell under these associated time and financial costs were:

- Associated software and resource costs were too high
- Fears around cost linked to lack of awareness of different solutions
- Businesses being time poor and MTD was not a critical priority
- Compliance with MTD was perceived to be an arduous task
- Running two systems in parallel for their first submission

3.3.1 Associated costs are too high for the business

Cost was a significant prohibitive factor for many businesses. This could be either in the form of costs associated with subscriptions to MTD compatible software, or with lateral changes that would need to happen concurrently to other bookkeeping processes and systems. Businesses were often not accustomed to having to pay regular fees for tax software, and the adjustment was one that was hard acclimatising to, and often had not been budgeted for. When lateral changes, like server updates for example, were required alongside changes to accounting software, it added to the reluctance to comply with MTD. Businesses who felt put off by these costs were generally not very aware of cheaper alternatives, such as bridging software, or the tiered packages most software providers offer based on functionality required, but instead believed that to be MTD compliant they would have to make wholesale changes and become fully automated with extensive accounting functionality.

Case Study - Small Business, Manufacturing, Yorkshire

She currently runs the businesses' accounts using a legacy version of [software provider] which isn't cloud-based or MTD compatible. In order to move to an MTD compatible version of [software providers], she would have to install a completely new server, which combined with the cost of a subscription has significant cost implications. This is a cost her business could not currently withstand; however, she has recently found out that she could use bridging software in the meantime and the business is looking into changing their servers by 2022.

"I just find it frustrating that I've got to pay for something that I don't see why I need. My current system has been working perfectly well."

Sole Trader, Financial, Midlands

Fears around cost linked to lack of awareness of different solutions

Some who saw cost as a barrier lacked awareness about the range of compliant solutions available and felt MTD was only benefitting the software providers and HMRC, not small businesses. Not all businesses were aware of cheaper bridging software options as an alternative to full software packages. One business who had found a cheaper bridging software solution was too nervous about relying on it being officially MTD compliant so did not use it. Amongst these businesses, there was a frustration that HMRC were not offering more guidance about software solutions, or a software product of their own. It could feel to these businesses like the only people benefiting from MTD were third-party software companies and that the only tangible benefit to them complying was avoiding a fine from HMRC.

"I was like 'I'm not being funny, but if this is by law you're cashing in on this'...They've got you by the short and curlies. I think MTD is a bit of a money-making scheme for [software provider]."

Micro Business, Manufacturing, Midlands

3.3.2 Businesses are time poor and MTD is not a critical priority

In smaller companies, the individual responsible for the bookkeeping also tends to run most of the back-office operations, and sometimes more. For these individuals, compliance with MTD for VAT was therefore just yet another priority that they had to attend to. There were often other more business-critical activities that demanded their time and attention, so finding the time to really understand what they needed to do to be compliant proved difficult.

"I'm doing a lot more hours in the office than I used to, and my brain is exhausted come the end of the day [when she does her taxes] and my eyes are sore from being in front of the laptop all day."

Micro Business, Wholesale, East of England

"At the end of the day, the accounting is very secondary to getting the business in because if you don't get it in you've got nothing to account for."

Micro Business, Professional Training, South East

3.3.3 MTD is perceived as a big task that will take time

Both through exploring time barriers with participants, and through speaking to those who recently had become compliant, it emerged that signing up to MTD is often perceived as a very lengthy task. This perception was shaped both by the tone of communications about MTD and through past experiences in dealing with tax related issues, for example long phone calls to

HMRC. This put businesses who had not yet started their compliance journey off from addressing the task. And for those who had already complied, they tended to be pleasantly surprised at both the length of time it took, and the benefits they experienced through complying. Those who had used bridging software in particular found the process a lot easier than expected.

“I don’t find the HMRC website the best to navigate...I’m always thinking, ‘Oh, God, I’ve still got to read all that,’ and then I’ll click that and it opens another page, and I’ve got to read that. I admit, I did put it off for a while, because I just kept thinking, ‘Oh, God, I haven’t got time to do that.’”

Micro Business, Manufacturing, Midlands

Case Study - Small Business, Leisure, Midlands

He has very recently signed up to MTD and made two MTD submissions. He switched from paper to [software provider] and has found that the change is bringing a lot of benefits to the company – saving on accountant fees and saving on time spent bookkeeping. He was very surprised at how easy it was to get signed up to MTD. He had allotted a lot more time to it than it actually took in the end.

3.3.4 Running two systems in parallel for their first submission

A lack of confidence in individuals’ own technical ability and the perceived (lack of) reliability of the new software / system meant that several businesses were planning on running or indeed already running two systems in parallel for their first few submissions. They would do this until they were confident in the new processes involved in making an MTD compliant submission. Increasing the time and resource required to complete their VAT returns adds to the chances that businesses will put off compliance with MTD.

“I’m still not sure in my abilities when it comes to using [software provider] as I just can’t get the same numbers I get when I do it the old way... Having to do everything twice just means I’ve only tried to do an MTD submission once in the last year or so...and as you probably know it didn’t work.”

Micro Business, Health and Safety Consultants, Midlands

Case Study – Sole Trader, Financial, Midlands

Her accountant signed her up to MTD on her behalf. She believed she was moving from paper to [software provider] by her accountant, she says doing her VAT now takes a whole day as she is running her old paper system and [software provider] in parallel in order to check [software provider] is calculating the figures correctly. This is a constant frustration to her, as before MTD it would only ever take her a couple of hours.

3.4 Factors outside of their control

There were inevitably some factors that were outside the control of businesses and would be hard for HMRC to address. These factors were:

- Illness in the business
- Technical issues when submitting
- Poor broadband speed

3.4.1 Illness in the business

With small and micro businesses and sole traders, illness amongst staff can have a significant impact on operations. For one business we spoke to, who encountered this as a barrier to compliance with MTD for VAT, the person responsible for the company's bookkeeping and thus MTD had recently had a stroke. This business was therefore behind where it had hoped to be in terms of MTD compliance as the increased task load for the remaining employee meant that they had not got around to addressing MTD yet.

3.4.2 Technical issues when making submissions

There were a small number of businesses who were unable to make an MTD compliant submission because of technical issues they encountered on the HMRC website. These businesses were however doing their best to comply and so are unlikely to be penalised under the 'light touch' approach to penalties. In the instances when these technical issues were encountered, businesses were advised that they were unlikely to be penalised and to wait until their next submission to make an MTD compliant one. For example, one business tried to make their first MTD compliant submission in September however the HMRC website would not let them. After speaking with someone on the phone from HMRC, they were advised that because of technical difficulties with the website, they should wait until next quarter before making an MTD submission.

3.4.3 Poor broadband speed

For some businesses in remote locations, a poor broadband speed can be a significant barrier to MTD compliance. This was a very real barrier for these businesses, as when speeds are bad, setting up new software can be a lengthy or even an impossible task. For one business in a rural location, they reported that their poor broadband connection meant they could not submit an MTD compliant submission. The business was locked in to a broadband contract that only ended very recently. Only now that the business has a faster broadband connection can they start to think about MTD. Businesses facing this barrier were generally not aware of the exemption in place for those with poor broadband.

4. Reactions to existing and new messaging

This section highlights businesses reactions to and perceptions of key MTD compliance messages sent to them in either reminder letters or emails and explores their thoughts on and responses to new messaging designed to encourage MTD compliance from April 2020 onwards.

4.1 Existing messaging - reminder letter key phrases

4.1.1 What was tested and how?

Businesses were read statements by researchers taken from a reminder letter or email sent to them from HMRC between July 2019 and February 2020. They were asked if they recalled receiving these messages from HMRC at all, and what their reaction to hearing them now was (regardless of whether they could recall reading them or not). The order in which the statements were read out was rotated across interviews.

The four statements from the reminder letters / emails tested were:

- 1. Hundreds of thousands of businesses have signed up to a new service called Making Tax Digital. We have noticed you are not one of them.*
- 2. Your business has missed the deadline for new VAT filing regulations.*
- 3. You are now in the small minority of businesses that did not sign up to Making Tax Digital before the deadline for submitting your VAT return.*
- 4. If you do not sign up before the deadline for submitting your next VAT return, HMRC will treat you as if you meant to miss it.*

4.1.2 How did businesses respond?

After being read the statements from the reminder letter or email, most businesses could not recall receiving them from HMRC, but some vaguely remembered key phrases when probed. When asked how they might have received this information from HMRC, only a few could confidently recall what format the information came in; some suggested in a letter, the majority thought it might have come in an email, and some guessed through the HMRC website.

Moving on from whether they recalled receiving the letter or not, moderators probed around businesses' reactions to hearing the statements; how do they react, what information feels relevant, how do they judge the tone of the statements etc. Amongst businesses there were two distinct reactions to the messaging. Firstly, there were those businesses for whom the statements did not inspire any action, but instead made them cynical about the letter or email.

These businesses believed they would not take any action as a result of reading the reminder letter or email and would in fact feel sceptical about whether the letter or email was truly meant for them. This belief was influenced by how generic the text was and further shaped by the common misunderstanding of the term 'digital'. So, for businesses who were (incorrectly) under the impression that they were MTD compliant, feeling sceptical about the letter / email was a very common reaction.

As the messages within the letter could feel generic and lacking personalisation, many businesses believed that if they received it in the post, they would discard it after first reading on the basis that it was a circular sent round to all businesses their size and did not directly apply to their business.

"It's one of those things, you get so many emails and you get so much generic stuff, you know 'for your information'... it's not specific to you ...you stop paying attention in the end."

Micro business, Construction, South East

"If I'd read any of those, I'd assume well I'm doing it online, what else do they want me to do?"

Micro business, Manufacturing, South East

In contrast to the businesses for whom the letter / email would not inspire action were those who felt even more stressed than they were already as a result of reading it. Some businesses were already undergoing actions in order to comply with MTD and were often all too aware of the approaching end of the 'light touch' period (March 2020).

For this group, the tone of the reminder letter / email could feel overly aggressive and uncompromising. The phrase for example 'HMRC will treat you as if you meant to miss it [the MTD submission deadline]' felt too insensitive to those already trying hard to comply, and they believed that HMRC should in some way acknowledge their efforts to comply rather than threaten them. Businesses that felt stressed by the reminder letter /email also called for more signposting to help and support from HMRC. In its current form, they felt the reminder statements were not offering a solution to those struggling with compliance, let alone some sort of acknowledgement of their efforts.

"I'm not doing this for the goodness of my health, I've got a problem with it, I can't do it. That's fine as long they back it up with, 'We want to help you tone,' rather than, 'We're going to fine you.'"

Micro Business, Manufacturing, Yorkshire

"The tone can come across quite aggressive...I probably would have thought 'I will get it done, but sod you!'"

Micro Business, Education Trust, Midlands

Despite these two distinct reactions from businesses, there were some reactions to the statements common across most businesses. The opening phrase of the first statement, 'Hundreds and thousands of businesses have signed up', was felt to be particularly motivating and had the most recall. Information about deadlines however was less effective, with most left confused about whether they had missed a deadline or if there was another one coming up.

"I think they need to phrase things differently... Give us clear, defined deadlines." **Small Business, Manufacturing, Yorkshire**

4.2 New messaging – future key phrases

4.2.1 What was tested and how?

HMRC were keen to explore a combination of new messages designed to encourage mandated businesses to sign up to MTD for VAT. Businesses were asked a series of questions relating to their thoughts and impressions regarding three new statements developed by HMRC. Each statement was read aloud before discussing businesses reactions to and feelings on the tone, relevance, credibility and call to action potential of each statement. The order of statements was rotated across all interviews, with the content of the statements presented in the box below.

The three new statements were:

- 1. You were required by law to start using Making Tax Digital for your VAT in 2019, but have not yet done so. You must join in time for your next VAT return.*
- 2. It is much more likely that HMRC will open an enquiry into your VAT affairs if you do not start using Making Tax Digital for your VAT.*
- 3. You may be subject to financial penalties if you do not start using Making Tax Digital for your VAT.*

Finally, businesses were asked to consider the idea of a fourth statement that combined key messages from statements two and three: *If you do not start using Making Tax Digital for your VAT, you may be subject to financial penalties and HMRC are more likely to open an enquiry into your VAT affairs.* The tone, relevance, credibility and call to action potential of the final statement was explored with businesses, as well as discussing how this statement compared to the other three.

How did businesses respond?

Overview

Similarly to the reminder letter or email, there were two distinct reactions to the new statements. Businesses who were more complacent and lacked urgency to becoming MTD compliant felt the messages within each of the statements were quite vague and ambiguous and needed to be firmer to 'push' them into action. This group felt they had other business critical priorities to address and did not view becoming MTD compliant seriously. Effective messaging for this group would need to be firmer and more directive to make MTD compliance a business-critical priority.

"Unless they put in a figure [for the financial penalty] that's going to frighten somebody, people will just forget it and not take any notice of it."

Micro Business, Agriculture, South West

However, businesses who were trying to become MTD compliant but had encountered various barriers were very aware of the need and urgency to sign up to MTD and felt the messaging was too punitive and failed to recognise their efforts to comply. This group resented suggestions that they were being complacent and were keen that any future messaging could signpost them to find the necessary support required to become compliant, or at the very least enable businesses to flag with HMRC that they are having issues. For example, some business wanted an email address where they could engage an advisor in a conversation and where they would have a record of what had been said (for an audit trail) to evidence that they were trying to comply with the law.

"People are really mindful of having some sort of a trail that they can say 'well I emailed you and you said this'."

Micro Business, Education, East of England

"I think it needs to be tempered with something that says 'if you are having problems, or if there is a reason why you haven't done it'...maybe there should be a dedicated helpline where phone calls are registered so that HMRC knows they've got some sort of an issue"

Micro Business, Communications, North West

Statement one

Overall, businesses felt the first statement - *You were required by law to start using Making Tax Digital for your VAT in 2019, but have not yet done so. You must join in time for your next VAT return* - was credible and fair but might lack force for those not yet signed up by choice. Businesses felt the phrase *'required by law'* was an effective call to action and resonated most with businesses who lacked urgency to comply. However, citing the 2019 deadline followed by, *"You must join in time for your next VAT return"* evoked confusion around the actual deadline for compliance. Those who were more complacent felt the message suggests the 2019 deadline

was obsolete and the actual deadline was their next VAT submission, meaning there was no real rush to comply. A few businesses suggested the lack of consequences during the 'light touch' period resulted in an attitude of 'what's the worst that could happen if we don't comply' and having one firm deadline would be more effective in mobilising them into action and encouraging them to comply.

"I think I would register almost immediately... If you're getting the wrong side of the law, as a property professional it's really something... because you don't want to be breaking the law."

Sole Trader, Real Estate, Scotland

"If you've not been doing it at all, haven't bothered trying, then you'd think 'okay right I need to do this'. But then again if you've ignored all the previous ones, then I doubt that would make much difference."

Micro Business, Administration, South East

Statement two

The threat of an enquiry into a business's VAT affairs was not motivating for a variety of reasons. Some felt they could easily withstand an enquiry and were confident they had not done anything illegal, especially those who had proof they were making efforts to comply with MTD. Others welcomed an enquiry, as it promised direct contact with someone from HMRC to help them overcome the barriers they encountered, with businesses finding it hard to find this level of support through other avenues. Businesses who needed a hard push to becoming compliant felt phrases like '*much more likely*' were vague and ambiguous meaning the chances that HMRC would conduct an enquiry would be reasonably small. This resulted in a lack of urgency or motivation to comply. However, businesses already trying to comply felt the threat of conducting an enquiry was particularly harsh without the offer of support or signposting.

"I think they're trying to frighten you that they're going to send someone round to check your books...I've got nothing to hide so it wouldn't bother me."

Micro Business, Wholesale, East of England

"I'm trying! Do they think I'm not trying? In fact, an enquiry would at least mean I could speak to someone from HMRC who knows what they're talking about."

Micro Business, Media Consultancy, Midlands

"That would get my back up. That would really annoy me... 'How dare you? I've never returned anything late, just cos you want me to move (to MTD) you're starting to threaten me now. I wouldn't like that at all."

Sole Trader, Finance, Midlands

Statement three

Businesses felt the threat of a financial penalty was the most motivating and tangible approach to becoming MTD compliant. It was also what most businesses expected from HMRC. Again, phrasing like *'you may be subject to'* was seen as vague and ambiguous, raising doubts that HMRC would follow through with this, particularly amongst those who do not feel there is any urgency to sign up to MTD. Some felt the use of the word 'fine' was a more direct and effective alternative to 'financial penalty'. These businesses also suggested the size of the fine would need to be significant enough to discourage those considering taking the fine rather than becoming compliant. However, businesses who were trying to comply but encountered various barriers felt this statement was very harsh, especially without the offer of or signposting to support.

"It would make me think I need to actually definitely get it done now. And if I can't get it done for the next time, I need to let them know why I can't do it, and make sure it's written on (my) file."

Micro Business, Communications, Northwest

"That definitely hits the nail on head, because nobody wants to get fined."

Sole Trader, Manufacturing, West Midlands

Statement four - combining statements two and three

Reactions to a combined statement tended to mirror businesses thoughts and impressions expressed towards statements two and three. With those trying to become MTD compliant finding the messaging threatening and unnecessarily punitive, creating a negative perception of HMRC. While businesses who were a little more complacent found the messaging useful but again felt the use of subjunctive words such as 'may' caused a level of ambiguity which detracted from the importance of the message.

5. Concluding thoughts and considerations

This research used qualitative evidence from 44 businesses to provide a deeper understanding of the motivations behind non-compliance, highlight the key barriers and enablers in becoming compliant, and develop effective messages that would encourage business to become MTD compliant. This section will summarise the motivations behind and reasons for non-compliance and highlights the most effective messages or approaches to take to support business in becoming compliant.

5.1 What were the motivations behind and reasons for non-compliance?

While there were businesses who lacked urgency to comply with MTD for VAT, most were trying to comply but encountered a variety of barriers and wanted further support and signposting from HMRC or software providers to overcome these. Overall businesses lacked a clear understanding of purpose and rationale driving MTD for VAT and were unaware of any potential benefits to them or HMRC. Having a better understanding and awareness of the drive and reasons behind MTD for VAT has the potential to increase motivation amongst non-compliant businesses to sign up to and comply with MTD.

Migrating to MTD compatible systems was perceived as a big, complex and costly task with many businesses lacking awareness of the range of software solutions available to them. This was further compounded by a misunderstanding or misperception of what being MTD compliant actually meant, with many being confused by the term 'digital'. This suggests a clearer definition of what is meant by 'digital' and 'digital links' is necessary to avoid confusion around whether a business is compliant or not.

5.2 Thoughts and impressions on key messages

The use of language across all messages and communications needs to be more direct and definitive to avoid confusion and mitigate the risk of businesses not taking the messages seriously enough or ignoring the messages altogether. In particular, the use of subjunctive words such as 'might' or 'may' does not resonate with businesses, particularly those reluctant to comply, and should be avoided. It could also be worth considering wider ways to convey urgency similar to other policies or processes requiring compliance, such as the TV license with the red writing on the envelope. However, the pitch and tone of messaging needs to be balanced and must account in some way for those businesses trying to comply but encountering problems. This could be addressed through the provision of and signposting to support and help mechanisms from both HMRC and third-party software providers.

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