

## EXPLANATORY MEMORANDUM TO

### THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2018

2018 No. 261

#### 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 This instrument introduces a requirement that an electronic account (“the electronic account”) is to be kept for VAT purposes and specifies the information it should contain. The vires for this provision are provided by paragraph 2(1) of Schedule 11 (“Schedule 11”) of the Added Tax Act 1994 (c.23) (“VATA”). Paragraph 6(1) of Schedule 11 requires a taxable person to keep such records as are specified by the Commissioners of Revenue and Customs (“the Commissioners”) in regulations. Paragraph 6(5) of that Schedule permits the Commissioners to provide by regulations for the form in which and the means by which specified records are to be kept and preserved. This instrument specifies the electronic account as a record that must be kept and also requires that it must be preserved in an electronic form. Paragraph 6(7) of Schedule 11 provides that if regulations under paragraph 6(5) 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 for the exemption required by paragraph 6(7) by making the precursor obligation to keep an electronic account subject to the exemption specified in that sub-paragraph. In addition the provision that the electronic record is preserved using electronic means applies only so long as the taxpayer is subject to the precursor obligation.

### *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 might 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 under sub-paragraph (5) 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 paragraph 6(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 billion<sup>1</sup> 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 service 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 businesses above the VAT registration threshold will be mandated to participate in Making Tax Digital from 1 April 2019. Businesses with turnover below the VAT threshold will not be required to use the system but can choose to do so.
- 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, 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 closely with the software developer industry to help them bring a wide range of functional compatible software to the market.

### *Consolidation*

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

## **8. Consultation outcome**

- 8.1 In August 2016 the government published 6 consultation documents. The particular consultation relevant to this Statutory Instrument was called ‘Bringing business tax in to the digital age’<sup>ii</sup>. HMRC received 618 written responses from individuals (including businesses) (153), accountants (264), representative bodies (40) and others (161). The consultation response was published in 31 January 2017<sup>iii</sup>.
- 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, administrative 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<sup>iv</sup> was published for consultation. HMRC received 43 responses about this document. In December 2017, HMRC published a draft of this instrument and a draft VAT Notice for technical consultation<sup>v</sup>. It received 60 responses from accountancy bodies and firms, large and small businesses and other professional organisations, as a result of which some changes to the instrument have been made.

## **9. Guidance**

- 9.1 New guidance, including a VAT Notice, which will provide information that supports the changes legislated for in this instrument, will be published in due course.

## **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 covering this instrument was published on 8<sup>th</sup> March 2017 on the website<sup>vi</sup>. Subsequently, a technical note containing a revised statement of impacts was published on 1<sup>st</sup> December 2017<sup>vii</sup>.
- 10.4 Civil Society organisations may potentially see an increase in requests for help and support from less digitally engaged individuals and business in transitioning to the new requirements. HMRC is continuing to work with Civil Society stakeholders to support the successful implementation of Making Tax Digital and the move to digital for both the organisations themselves and the people they represent.

## **11. Regulating small business**

- 11.1 This instrument applies to activities that are undertaken by small businesses, subject to an exemption for the smallest businesses (those with taxable turnover below the VAT registration threshold).
- 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.

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<sup>i</sup> 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](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655097/HMRC-measuring-tax-gaps-2017.pdf)

<sup>ii</sup> 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](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/545715/Making_Tax_Digital-Bringing_business_tax_into_the_digital_age-consultation.pdf)

<sup>iii</sup> 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](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)

<sup>iv</sup> 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>

<sup>v</sup> Making Tax Digital for VAT: draft legislation published 18 December 2017  
<https://www.gov.uk/government/consultations/draft-legislation-the-value-added-tax-amendment-regulations-2018>

<sup>vi</sup> Making Tax Digital for business published 8 March 2017  
<https://www.gov.uk/government/publications/making-tax-digital-for-business>

<sup>vii</sup> Making Tax Digital: changing the scope and pace - technical note published 1 December 2017:  
<https://www.gov.uk/government/publications/making-tax-digital-changing-the-scope-and-pace-technical-note>