Making Tax Digital for VAT for charities

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Introduction

Most VAT-registered charities and other businesses are, or will soon be required to:
- keep VAT transaction records in a prescribed digital format, and
- use 'functional compatible software' to digitally extract the information required for the VAT return from the digital transaction records, compile the figures for the VAT return and then send the VAT return to HMRC electronically, via a dedicated HMRC Applications Programming Interface ('API')

The storage of the transaction records, the extraction and compilation of the figures for the VAT return and the submission of the VAT return to HMRC via the API, must all be carried out entirely digitally, without manual intervention, though there is a 'soft landing period' during which the data extraction and compilation steps can be performed manually, though digital record keeping and digital submission of the VAT return via the API requirements must be implemented immediately upon entry into the regime.

HMRC refer to this as 'Making Tax Digital for VAT' ('MTD for VAT').

Start date

Most VAT registered charities and other businesses with taxable turnover above the VAT registration threshold (currently £85,000 per annum) had to implement MTD for VAT with effect from the start of the first VAT return period commencing on or after 1 April 2019. However, there was a 6-month deferral, to 1 October 2019, for:
- VAT groups
- Trusts
- not for profit organisations that are not set up as a company
- annual accounting scheme users
- those required to make payments on account
- VAT divisions
- Government departments, NHS Trusts, local authorities and public corporations
- traders based overseas

Such charities and businesses had to implement MTD for VAT with effect from the start of the first VAT return period commencing on or after 1 October 2019.

Charities and businesses that are newly registered for VAT (since 1 April 2019) on a mandatory basis (i.e. with taxable turnover above the UK VAT registration threshold), must implement MTD for VAT immediately upon registration.

Charities and other businesses which are registered for VAT voluntarily, with annual taxable turnover below the VAT registration threshold, will have to follow the MTD for VAT rules for their first VAT return period commencing on or after 1 April 2022.

Exemptions

A few charities and businesses are exempt from the MTD for VAT requirements:

1   Charities and businesses which are registered for VAT voluntarily (i.e. UK taxable turnover remains below the UK VAT registration threshold) are exempt until the start of the first VAT return period commencing on or after 1 April 2022
2   Charities and businesses subject to an insolvency procedure
3   Where the charity or business is run entirely by practicing members of a religious society whose beliefs are incompatible with the requirements (for example, those whose religious beliefs prevent them from using computers)
4   Charities and businesses for whom it is not reasonably practicable to use digital tools to keep business records or submit returns, for reasons of age, disability, remoteness of location or for any other reason (for example because there is no internet access available)

HMRC advise charities and other businesses that consider they are exempt under options 3 or 4 above to contact the HMRC VAT Helpline (phone 0300 200 3700, address HMRC VAT Written Enquiries,123 St Vincent Street, Glasgow City, Glasgow, G2 5EA).

Digital transaction records

The VAT transaction records must be held digitally in an electronic database or retrieval system, for example in an accounting software package, in an electronic database such as a CRM or donor management system, or in a spreadsheet system. However they do not all have to be stored in the same system, it is permissible to store digital transaction records across several different digital systems, though if several systems are used, they will have to be linked digitally from the end of the soft landing period.

The system(s) which record the digital transactions must be able to store, as a minimum, the following VAT related data for each sale or purchase transaction:

For each sale	For each purchase
• Time of supply (tax point) • Value of supply (net of any VAT) • Rate of VAT charged	• Time of supply (tax point) • Value of supply (net of any VAT) • Amount of purchase VAT to be claimed

Where the amount of purchase VAT to be claimed is not known at the time you record the supply, you can record:
• the total amount of VAT and adjust for any irrecoverable VAT once calculated
• VAT recoverable based on an estimated percentage and adjust for any VAT once calculated
• no VAT and adjust for any recoverable VAT once calculated

However, you do not have to retrospectively adjust each transaction individually, it is acceptable to record a single transaction to record the total recoverable or irrecoverable VAT for the VAT return period.

Transactions that are outside the scope of VAT

There is no requirement to digitally record transactions that are outside the scope of VAT and that do not have to be reported on a UK VAT return, for example:
- the receipt of most grants and donations
- payment of salary, PAYE and NICs
- intra-group transactions in a VAT group

However, it will usually be necessary to record such transactions for accounting, reporting and management purposes and then to exclude such transactions from the UK VAT return. Many accounting systems have a flag that can be set to indicate a transaction should be excluded from the UK VAT return. For example in some accounting packages (such as Sage, Quickbooks and Xero) the system uses VAT codes to specify how transactions should be treated for VAT purposes. If a VAT codes is flagged as 'Do not report', then transactions posted with that tax code are excluded from the UK VAT return.

API submission data

In order to be able to submit the VAT return via the API enabled software, the API submitting software must record:
- the business name
- the address of the principal place of business
- VAT registration number
- any VAT accounting schemes in use (e.g. annual accounting scheme, flat rate scheme etc.)

VAT return data

For each VAT return period the functional compatible software system must record:
- total output VAT due on sales
- total acquisition VAT due on acquisitions from other EU member states
- total tax output VAT due under a reverse charge
- total input VAT claimed on purchases
- total input VAT claimed on acquisitions from other EU member states
- any VAT adjustment following a correction or error adjustment, and any other adjustment allowed or required by VAT rules. A total of each type of adjustment must be recorded as a separate line.

Batching and splitting transaction records

In some situations, it is permissible to record several transactions as a single transaction or to record a single transaction as several. These include:

MIXED RATE SUPPLIES: If you need to apportion the output tax due on a mixed rate supply with a single inclusive price, for example membership subscriptions which are apportioned between VAT zero-rated, VAT exempt, you do not have to record these supplies separately. You can record the total value of the supply and the total output VAT due. If your software will not allow you to record a rate of VAT other than the standard, reduced, zero or exempt, the mixed supply can be recorded as either two or more separate supplies or you can record the sale at one rate and correct the VAT through an adjustment at the end of the VAT return period.

SALES AND PURCHASES MADE VIA AGENTS: Where a third party agent makes sales or purchases on your behalf, those supplies do not fall within the digital record keeping requirements until you receive the information from the agent. Where the information is received as a summary document you can treat this document as one invoice issued or received for the purpose of creating your digital record.

EMPLOYEE AND VOLUNTEER EXPENSES: Where you are claiming input VAT on employee or volunteer's expenses and that individual provides the combined value of more than one purchase, you do not have to record each purchase separately. You can record the total value and the total input VAT.

SUPPLIER STATEMENTS: Where a supplier issues a statement for a period you may record the totals from the supplier statement (rather than the individual invoices) provided all supplies on the statement are to be included on the same return and the total VAT charged at each rate is shown.

PETTY CASH PURCHASES: Where a business uses petty cash to pay for small value items, these do not need to be individually recorded in the digital records. The business can record the total value and the total input VAT. This applies to individual purchases with a VAT-inclusive value below £50 and the total value of petty cash transactions recorded in this way cannot exceed a VAT-inclusive value of £500 per entry.

CHARITY FUNDRAISING EVENTS RUN BY VOLUNTEERS: Where supplies are made or received during a charity fundraising event run by volunteers you may treat all supplies made as covered by one invoice for the event, and all supplies received as covered by one invoice for the event, for the purposes of the digital record keeping requirements.

REVERSE CHARGE PURCHASES: If your software is capable of recording reverse charge transactions you do not need separate entries for the self-supply and purchase. If your software does not

record reverse charge transactions you may record reverse charge transactions twice, once as a supply made to yourself and a second time as a supply received.

RETAIL SCHEMES: If you account for VAT using a retail scheme you must keep a digital record of your Daily Gross Takings. You are not required to keep a separate record of the supplies that make up your Daily Gross Takings within functional compatible software.

FLAT RATE SCHEME: If you account for VAT using the Flat Rate Scheme you do not need to keep a digital record of your purchases unless they are capital expenditure goods on which input tax can be claimed. You do not need to keep a digital record of the relevant goods used to determine if you need to apply the limited cost business rate.

MARGIN SCHEMES: You are not required to keep the additional records required for these schemes in digital form, nor are you required to keep the calculation of the marginal VAT charged in digital form. These records must still be maintained in some format.

Permitted manual adjustments

Many charities and other businesses must make periodic VAT adjustments, such as business/non-business and partial exemption adjustments to input VAT recovery. These do not have to be automated. For example, for VAT recovery calculations, the calculations can be performed manually in a spreadsheet using data that is manually imported from the digital records, with an irrecoverable VAT journal posted manually into the digital record at the end of the VAT reporting period. In effect, the adjustment becomes a part of the digital record.

Permitted manual adjustments include:
- business/non-business and partial exemption adjustments including annual adjustments
- Capital Goods Scheme adjustments for subsequent intervals, though the initial purchase transactions must be recorded digitally
- error corrections, where multiple errors are corrected retrospectively
- Import VAT certificates (C79s) are treated as an equivalent to a VAT invoice for import VAT. Therefore, the information contained in a C79 can be recorded manually on accounting software.
- change of VAT rate credit notes
- adjustments to VAT payable because of an increase or decrease in consideration of a supply made in previous period
- adjustments for use of an approved estimation procedure
- retail scheme adjustments
- change of use input tax adjustments
- bad debt relief claims
- aged creditor adjustments
- Tour Operators Margin Scheme (TOMS) adjustments
- Flat Rate Scheme (FRS) adjustments

- Global Accounting Margin Scheme adjustments
- road fuel scale charges
- private use adjustments

Digital links

The entire journey from the digital transaction records to the submission of the VAT return must be carried out by the functional compatible software via digital links, without manual adjustment or correction, other than permitted manual adjustments. However there is a soft landing period, during which businesses can carry on manually transferring data and manually compiling the VAT return figures, though transactions must be stored in a compliant digital format and submission of the VAT return must be via HMRC's MTD for VAT API.

A digital link is one where a transfer or exchange of data is made electronically between software applications without the involvement or need for manual intervention such as the copying over of information by hand or the manual transposition of data.

HMRC accept that digital links include the following:
- linked cells in spreadsheets, for example, if you have a formula in one sheet that mirrors the source's value in another cell, then the cells are digitally linked.
- emailing a spreadsheet containing digital records to a tax agent so that the agent can import the data into their software to carry out a calculation
- transferring a set of digital records onto a portable device (for example, a pen drive, memory stick, flash drive) and physically giving this to an agent to import that data into their software
- XML, CSV import and export, and download and upload of files
- automated data transfer
- API transfer

HMRC does not consider the use of 'cut and paste' or 'copy and paste' to select and move information, either within a software program or between software programs, to be a digital link.

However in HMRC's MTD Update for Agents number 13, issued 22 July 2020, HMRC announced it would accept manual adjustments can be made to imported data provided by a third party if required to get the data into the correct format for import. HMRC say:

'When electronic data is received from a third party, such as a customer, HMRC would prefer the data to be imported electronically into the system or software program used to maintain the electronic VAT account. HMRC accepts this may not always be possible – as not all electronic data is formatted in such a way that the accounting system is able to read it. In these circumstances the relevant information may need to be captured manually. For audit

purposes, linking the resultant transactional record to the original data (e.g. as an attachment) would be beneficial'

HMRC also added 'We recognise digital links can be a complex subject, so we are looking to provide more guidance on this topic and we will let you know more as soon as this is available.'

The soft landing period

The soft landing period will end at the start of the first VAT return period commencing on or after 1 April 2021. The soft landing period was originally due to last for one year from the start of each business's implementation of MTD for VAT (i.e. with effect from the start of the first VAT period commencing on or after 1 April 2020 or 1 October 2020 for deferred businesses) but was extended due to the COVID-19 pandemic.

Extending the soft landing period

Charities and other businesses with complex or legacy IT systems may require a longer period to put digital links in place. These businesses can apply to HMRC for additional time to do this. To be considered for an extension, you will need to:
- make a formal application to HMRC as soon as possible for an extension and by no later than the end of your soft landing period
- explain why it is unachievable and not reasonable for you to have digital links in place by the end of the soft landing period, for example, why does commercially available software not meet the digital link requirement for your business?
- submit details of the systems that are unable to be digitally linked (provide a current map of your existing VAT systems, highlighting the exact areas that cannot be digitally linked)
- provide a clear explanation and timetable for when and how you will become fully MTD compliant (ordinarily no later than one year from the end of their soft landing period)
- state the controls you will put in place to ensure any manually transferred data is moved accurately and without error
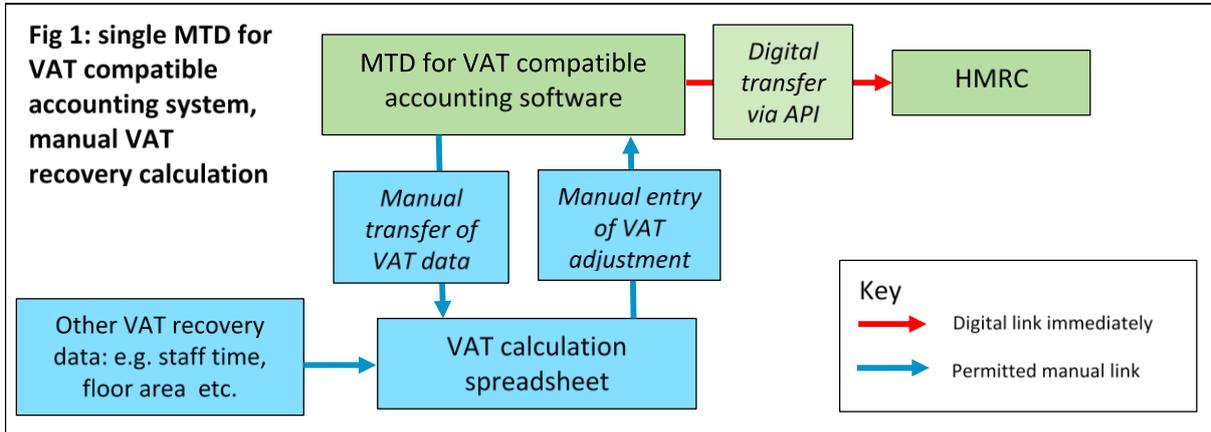
MTD scenarios for charities

The implications of MTD for VAT depend on the complexity of the charity's operations and accounting systems.

1 Single MTD for VAT compatible accounting system

Most of the standard UK accounting software packages have been made MTD for VAT compatible, for example Sage, QuickBooks, Xero, Access and Exchequer. Users of such products may need to upgrade to the latest version or install an MTD for VAT add on to their existing package. For a link to a list of commercial accounting software products that have been tested as MTD for VAT compatible see **Further Information** below.

Charities that use such products to keep all transaction records should find implementation of MTD for VAT relatively straightforward. Many of these packages also have facilities for compiling and submitting a group VAT return, in respect of two or more entities registered as a VAT group. As explained above, it is acceptable to carry out manual calculations for partial exemption, business/non-business apportionments, annual adjustments, Capital Goods Scheme adjustments etc.

Fig 1: single MTD for VAT compatible accounting system, manual VAT recovery calculation

MTD for VAT compatible accounting software → *Digital transfer via API* → HMRC

Manual transfer of VAT data

Manual entry of VAT adjustment

Other VAT recovery data: e.g. staff time, floor area etc. → VAT calculation spreadsheet

Key
Digital link immediately
Permitted manual link

In effect, you must make sure the accounts system's VAT module shows the correct VAT return figures before clicking its submit button.

## 2 Single accounting system – not MTD for VAT compatible

Some charities operate bespoke, old or non-UK products that have not been and will not be updated for MTD for VAT. Such charities have two main options:

- Switch to an accounting software product that is MTD for VAT compatible, or
- Extract VAT return data from the accounting system and use 'bridging software' to submit the return to HMRC via the API. Bridging software is software that is designed to link accounting systems, spreadsheets etc. to HMRC's systems via the MTD for VAT API. See **Bridging Software** below for further information.

FOR EXAMPLE:

VAT return data is extracted from the accounts system into a custom 'compiler spreadsheet' that compiles and calculates the figures for the VAT return. Up to the end of the soft landing period, the extraction of the data from the accounts system to the compiler spreadsheet can be by manual transfer, for example copy and paste. From the end of the soft landing period it will have to be via digital links, for example by importing the data, via a SQL query or via use of a dedicated utility, such as a product add-in for Excel.

The compiler spreadsheet then uses the extracted data to calculate the VAT return figures and populate the VAT return cells on an API enabled spreadsheet via digital links. HMRC require the link between the compiler spreadsheet and API submission spreadsheet to be digital immediately upon entry into MTD for VAT and there is no soft landing period.

Fig 2: single accounting system not MTD for VAT compatible, API enabled bridging spreadsheet
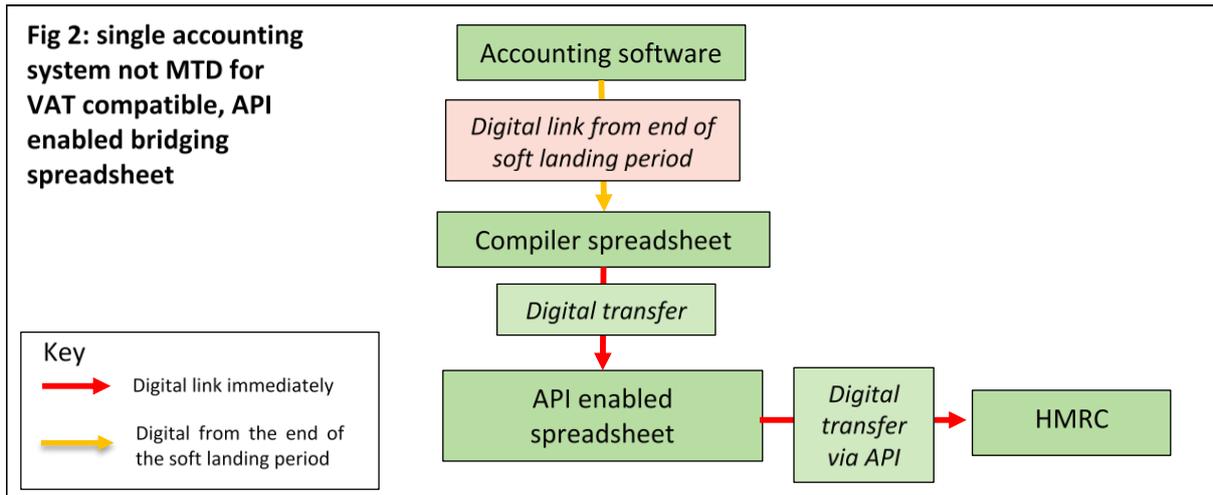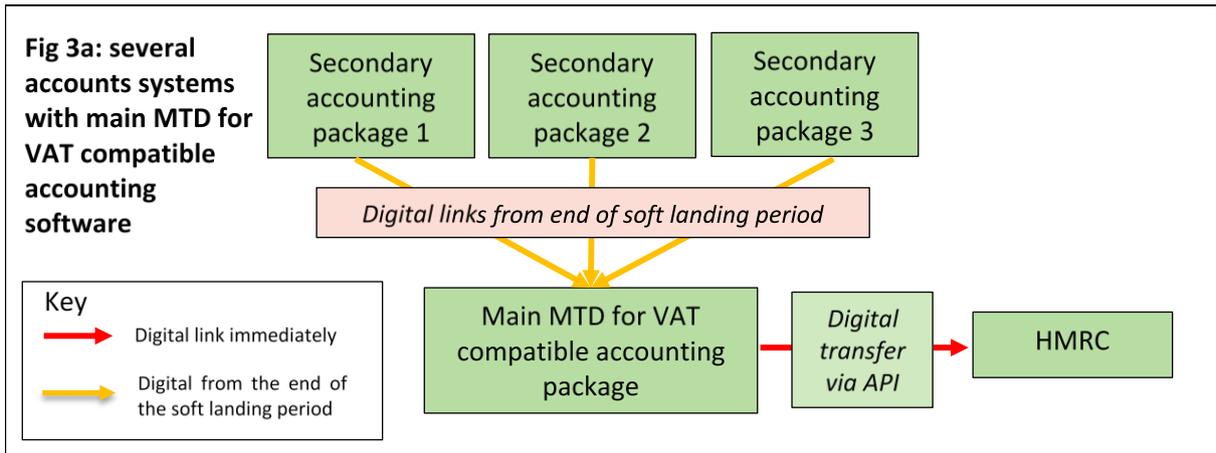
3 Several different accounting systems

Some charities use several different accounting systems, for example:

● A leisure trust might operate a 'main' accounts system which is a standard accounting software package together with one or more secondary systems such as specialist or legacy booking systems for individual leisure facilities

● A charity with retail or catering operations might operate a main accounts system with secondary EPOS systems for the retail and catering operations

● A fundraising charity might operate a main accounts system with a secondary system such as a donor management system, CRM system or event management system.
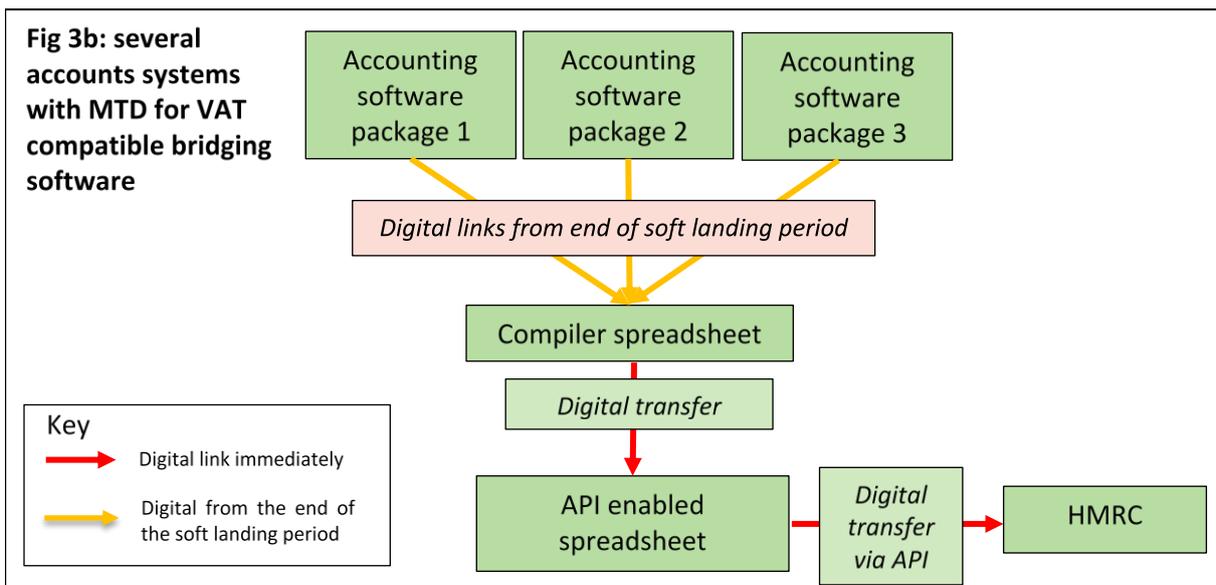
The digital transaction records can be stored in several different digital systems, provided each system meets the transaction data recording requirements. However, all links between the various systems for VAT reporting purposes must be digital from the end of the soft landing period.

There are several possibilities for charities in this position, for example:

a) If you have a 'main' accounts system that is MTD for VAT compatible, with one or more subsidiary systems that may or may not be MTD for VAT compatible, it might be possible to use the main system to submit the VAT returns and to transfer summary data from the secondary system(s) into the main system. For example, in the scenarios described above, the main accounts system could record the totals of standard-rated, reduced rate, zero-rated and exempt sales in the VAT return period from each secondary system. Up to the end of the soft landing period the summaries can be posted manually into the main system but from end of the soft landing period the summary data will have to be transferred via digital links

Fig 3a: several accounts systems with main MTD for VAT compatible accounting software

Secondary accounting package 1

Secondary accounting package 2

Secondary accounting package 3

Digital links from end of soft landing period

Main MTD for VAT compatible accounting package

Digital transfer via API

HMRC

Key

→ Digital link immediately

→ Digital from the end of the soft landing period

b) An API enabled spreadsheet bridging product could be used in conjunction with a compiler spreadsheet that takes data from the various accounting systems and compiles the figures for the VAT return. Up to the end of the soft landing period the data can be transferred manually from the accounting systems to the compiler spreadsheet, but from end of the soft landing period the data will have to be transferred via digital links.

Fig 3b: several accounts systems with MTD for VAT compatible bridging software

Accounting software package 1

Accounting software package 2

Accounting software package 3

Digital links from end of soft landing period

Compiler spreadsheet

Digital transfer

API enabled spreadsheet

Digital transfer via API

HMRC

Key

→ Digital link immediately

→ Digital from the end of the soft landing period

4 Spreadsheet based systems

It is also possible to keep transaction records in a spreadsheet system and use an API enabled bridging spreadsheet to send the VAT return data to HMRC. For example:

- One or more spreadsheets are used to record transactions
- An API enabled spreadsheet sends the VAT return data to HMRC

● The spreadsheet accounting system and the API enabled spreadsheet must communicate via digital links from the end of the soft landing period

Fig 4: spreadsheet system with compiler spreadsheet and API enabled spreadsheet
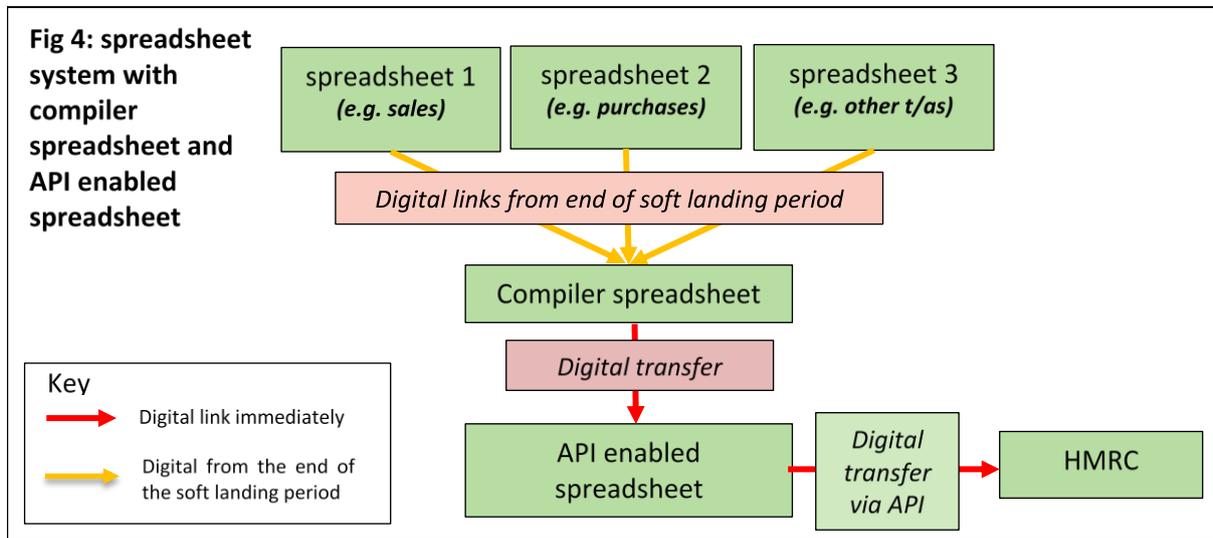
Bridging software

As explained above, if a spreadsheet is used to calculate adjustments that are posted back into an MTD for VAT compatible accounts system, for example to calculate recoverable/irrecoverable VAT for a VAT period, then the spreadsheet does not have to be digitally linked to the accounts system. However if a spreadsheet forms a direct link between the digital transaction records and API transferor (scenarios 2 and 3b above), or if some or all of the digital transaction records are stored in spreadsheets (scenario 4 above) then such spreadsheets will have to be digitally linked to each other and to any API enabled bridging product.

A review of the software products that have been tested as MTD for VAT compatible (see **Further Information** for a link) indicates there are broadly two types of spreadsheet bridging product available:

1   **Basic API enabled spreadsheets**. You essentially download an API enabled spreadsheet (usually an Excel workbook) which has pre-defined cells for entry of the VAT return figures (boxes 1 – 9), entity information (business name and address, VAT registration number, VAT period and other HMRC submission data) and a 'submit' button. You then populate the boxes 1 - 9 cells. This can be done manually up to the end of the soft landing period but must be via digital links from the end of the soft landing period. You then click the submit button. The API enabled spreadsheet then records any HMRC submission confirmation or message

2   **More sophisticated API enabled Excel workbooks**. These submit the VAT return data to HMRC via the API however they are also set up, or can be set up, to digitally extract the

relevant data from one or more specific digital systems, for example via SQL queries into an accounting system's database. The system then compiles and calculates the figures for the VAT return and submits it to HMRC

Miscellaneous points

EC sales lists and Intrastat Returns: EC sales lists and Intrastat returns are excluded from MTD for VAT and should be submitted as usual.

Mini-One Stop Shop Returns (MOSS returns): MOSS returns are excluded from MTD for VAT and should be submitted as usual.

Non-established taxable persons: A charity or business that is established outside the UK and which does not have a fixed establishment in the UK, but nevertheless makes taxable supplies in the UK (a 'non-established taxable person' or 'NETP') may have to submit UK VAT returns in respect of UK sales. Up to 1 April 2022, an NETP will only have to submit UK VAT returns via MTD for VAT if its UK taxable turnover exceeds the UK VAT registration threshold (currently £85,000). With effect from 1 April 2022 an NETP will have to implement MTD for VAT if it makes any taxable sales in the UK.

Further information

HMRC VAT Notice: https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat

Software that has been tested with HMRC's MTD for VAT API: https://www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-vat