

The future of tax compliance is digital

Jesminara Rahman explains what you need to know to about digital records to prepare for the digitalisation of tax compliance

HMRC has increased its digital resources as they have recently recruited for digital resources, appointing Heads of digital design across all its main digital hubs including London and Bristol. HMRC are making concerted movements and efforts to implement programmes to digitalise VAT and income tax.

From April 2022, the Making Tax Digital programme will be extended to all VAT registered businesses with turnover below the VAT threshold, and from April 2023 it will apply to taxpayers who file income tax self-assessment tax returns for business or property income over £10,000 annually.

HMRC has consistently identified in their tax gap report that small business are responsible for 43% of the tax gap. Therefore, it is important that agent and business owners are able to advise their clients on the digital records that should be kept, as they will come under scrutiny when HMRC are conducting their compliance checks. Especially now, as HMRC will be seeking ways to digitalise their compliance processes, due to the impact of Covid-19 on the normal working ways of HMRC.

The digitalisation of tax will help HMRC to streamline their risk assessment processes for future tax compliance checks and allow the increasing use of data mining to compile risk assessment profiles for future tax cases.

HMRC requires in general that six years of records are to be maintained for VAT purposes. When a VAT officer visits the business they will carry out a risk assessment normally on the past four years of VAT returns and will take note of any VAT repayments and unusual dips in the trade. HMRC will need to understand the audit trails between the records and how you got to the figures in the VAT return.

According to VAT notice 7000, the basic rule is that you must create and keep normal business records, which is quite a vague description. To be more specific you need to keep the records used to reach the figures in your tax returns. You do not have to keep records in a set way and most bookkeeping and computer systems will meet this requirement.

Making Tax Digital for VAT currently requires VAT registered businesses with taxable turnover above the VAT registration threshold to keep records in

digital form and file their VAT Returns using software.

The difference under Making Tax Digital is that the software which businesses use must be capable of keeping and maintaining the records specified in the VAT regulations, preparing their VAT Returns using the information maintained in those digital records and communicating via digital link to submit the VAT returns to HMRC digitally.

The following rule has the force of law as outlined in VAT Notice 700/22:

- A digital link is an electronic or digital transfer, or exchange of data, between software programs, products or applications.
- And that the use of 'cut and paste' or 'copy and paste' does not constitute a digital link.

Under Making Tax Digital, the records must be kept digitally within functional compatible software.

Do we have to keep digital records?

Only if you come under the conditions below:

- If it's not reasonably practicable for you to use digital tools to keep your business records or submit your VAT returns because of age, disability, remoteness of location or for any other reason.
- If you or your business are subject to an insolvency procedures.
- If your business is run entirely by practising members of a religious society or order whose beliefs are incompatible with using electronic communications or keeping electronic records.
- If you're already exempt from filing VAT Returns online.

What records do you need to keep?

In general, it is the records upon which you would base the tax return upon; the daily sales records, purchase invoices and so on. However, some VAT schemes have specific requirements; for example the VAT retail scheme states that a digital record of daily gross takings must be kept. The VAT flat rate scheme does not require input records, but then you would need to retain these records for income tax or corporation tax purposes. You must also keep a digital records of the trades designatory data – business name, the address of your principal place of business, your VAT registration number and any VAT accounting schemes that you use.

If the scanned records encapsulates all the details required for VAT purposes

(i.e. VAT number, tax date point, VAT rate and amount) then the business does not need to keep the original invoice unless it is required for another purpose. The scanned invoice would be considered as digital records according to VAT notice 700/22.

HMRC does simplify some requirements in that if there is a statement provided by a supplier then the total amount can be used and entered in the VAT account rather than individual breakdowns.

Digital records for compliance checks

However, we need to note that when HMRC carries out their compliance checks, officers like to test out end-to-end transactions from the point of purchase to the point of sales of the product to the banked sales receipts, when testing the records.

With the impact of the Covid-19 there will be an increase of desk compliance checks as HMRC are not carrying out any physical assurance visits to trades in this current tax year. Digital records will become increasingly important in tax compliance cases as it reduces the need for physical interaction.

For more go to <https://tinyurl.com/y8uev24q>

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