Digital Links:

A guide to MTD in 2021

TAX **SYSTEMS**

Executive summary

The first phase of Making Tax Digital (MTD) saw the requirement for the digital submission of the VAT Return using compliant software. That's now behind us but 2021 brings new challenges. Under Phase 2, businesses that exceed the £85,000 threshold will need to have digital records and digital links in place to create an automated end-to-end VAT process. Achieving this is likely to be more complex and there are a number of ways in which the business can comply, necessitating the evaluation of the options in the light of what the business hopes to achieve.

In this report we:

- Summarise HMRC's objectives under MTD
- Look at the success of the rollout to date and attitudes in the market
- Consider the implications of the delay to the digital links mandate
- Explore the opportunities presented by Phase 2 under MTD for VAT
- Review the requirements under Phase 2
- Identify the things to watch out for including:
  - Penalties and the implications of the end of the soft landing period
  - Data collection and data quality
  - Amendments and adjustments
  - Errors and the risk of non-compliance
  - Managing the process
  - Future change
- Examine the strengths and weaknesses of the four main compliance choices.

What is an HMRC compatible MTD solution?

HMRC has stipulated that Functional Compatible Software (FCS) must be used to submit the VAT Return via its API.

But what is FCS? Many refer to a 'bridging solution' instead which they use to complete and submit the Return.

FCS usually takes the form of an API-enabled spreadsheet, an add-on to an existing accountancy package, or a dedicated software compliance engine which obviates the need for spreadsheets by performing calculations, amendments and adjustments.

You may need to ask whether your existing solution for Phase I compliance is capable of supporting digital links under Phase 2. To do this it must digitally link back to source data held in the digital records and be able to extract this and use it to populate the Return.

HMRC objectives for MTD for VAT

Prior to MTD, VAT reporting generally saw businesses performing manual input and calculations even into the online portal, as well as keeping physical copies of records; practices that were prone to error. Advances in technology have now made it possible for HMRC to streamline and increase transparency (and tax take) in tax reporting processes.

Automating reporting from source to submission should reduce the likelihood of errors and make those that do occur easier for tax authorities to detect. With this in mind HMRC identified three goals for its MTD for VAT programme:

Digital records
Businesses were tasked with implementing digital record keeping from the launch of MTD for VAT in April 2019 but the soft landing period gave them the breathing space to comply. This soft landing period will end on the date of the first Return after April 2021.

Digital links
Digital records will become digitally linked to the digital submission process from April 2021.

Digital report submission
Although the last piece of the process, it was decided to tackle the digital submission element first under MTD for VAT as this was the least disruptive. All those that exceed the MTD for VAT threshold of £85,000 must now submit their Returns digitally via the HMRC API. Once registered, a business must continue to file digitally even if its Returns dip below this threshold.

'In the 2018-19 tax year, £10bn of the estimated £31bn tax gap was attributed to VAT with the biggest contributor being a "failure to take reasonable care" (£5.5bn)'.

So what happened, where are we and what have we learnt?

Uptake
Phase 1 of MTD for VAT is considered to have been a success, with around 1.4 million signing up to the service, 94% of whom have filed on time, while a further 265,000 businesses under the threshold have opted to do so. More than £38.5bn in payments and more than £13bn in repayments had been processed by March 2020.

In its review of MTD phase 1[1], HMRC found that those who had found the transition to MTD to be both painless and productive had used "fully integrated software to manage their finances in real-time" and that as "businesses now only enter information once" it was "easier to spot and correct mistakes at source" due to "intuitive and easy-to-use navigation and dashboards". These businesses therefore reported a "reduction in input error when compared with previous methods" and that "businesses spend less time overall dealing with their tax affairs".

Businesses that had opted for dedicated software (as opposed to a bridging solution) for Phase 1 compliance reported that:

• **Input errors were reduced** due to digital linking and automation, meaning data only had to be input once
• **Returns were more accurate** because data was fed in on a daily routine basis
• **Miscalculations were reduced** as figures were calculated automatically by the software
• **Errors were corrected quickly and easily** due to the frequent input, automatic bank reconciliation and the management software itself

In contrast, those who had opted to use a bridging solution, regarding this as a "safer option than becoming fully compliant" and who had done so to minimise changes to their record keeping and accounting methods, reported feeling "frustrated" as they "felt no benefit" from MTD. The research found that this bridging software had "minimal impact on the scope of error" and the expectation was that these businesses would have to invest in other software solutions in the longer term.

Going forward, the MTD Software Advisory Group at the ICAEW have voiced concerns that the automation of the process could result in inaccuracies unless users have the ability to check and amend errors.

[1] 'Making Tax Digital: An evaluation of the VAT service and update on the Income Tax service Budget 2020', HMRC, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/873574/Making_Tax_Digital_-_An_evaluation_of_the_VAT_service_and_update_on_the_Income_Tax_Service.pdf

Impact of the Pandemic

The Coronavirus pandemic has had a significant impact on the roll out of MTD. The digital links mandate, originally planned for April 2020, was delayed until April 2021. This saw the compliance deadline extended by twelve months for the majority of businesses and by six months for those large businesses caught under the original deferral period. It also saw the extension of the soft-landing period for all businesses until 1 April 2021.

The pandemic also saw a raft of measures brought in under the VAT regime to support businesses. The rate was lowered from 20% to 5% for businesses operating in the hospitality and tourism sectors which will stay in force until March 2021 at which point it will be reviewed. A VAT deferral was also applied to payments due between 20 March – 30 June 2020, effectively enabling VAT payments for February, March and April 2020 to be deferred.

Deferred payments will become due by 31 March 2021, however, to ease pressure on businesses a New Payment Scheme was launched allowing VAT to be paid over 11 instalments to March 2022. Up to half a million businesses are thought to be eligible for the scheme which could see up to £30bn deferred.

Those wishing to take advantage of the scheme must opt-in by 31 March 2021 and cannot ask their agent to do so on their behalf.
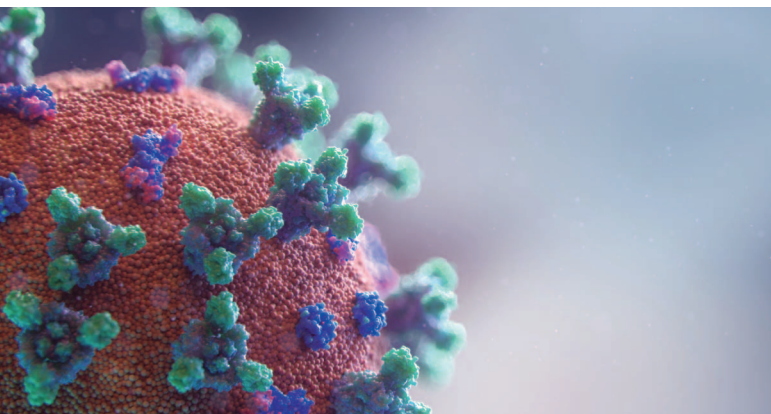
The digital links mandate was delayed from April 2020 to April 2021. This has been welcomed as it will allow…

Businesses to take stock
Rather than seeking to satisfy compliance demands which 69% admit was the chief driver in 2020, there's now the opportunity to explore how the business can digitalise its tax processes in a way that improves both efficiency and accuracy.

Technology vendors to improve their offerings
MTD solutions can now be built out to address other issues such as data quality and to handle complex calculations such as partial exemption recovery. Expect error detection to also become more accurate through the application of tax logic to identify anomalies. And solutions will also become more autonomous, with self-help built-in, to prevent tax teams from having to rely upon IT helpdesk support.

The market to adjust to the cost and upheaval
The COVID-19 crisis is expected to result in a national debt of more than £337bn and there has been significant disruption to tax mechanisms. Businesses need the time to get their payment schedules back on track and to prepare for greater scrutiny. Armed with additional resources – including 1300 new compliance officers and new technology – the likelihood is that HMRC will come down hard on businesses in 2021.

Knock-on effects

The rapid changes brought in under the VAT regime have done more than just help protect business cashflow. They have also made businesses more reactive. In addition to closely monitoring their bottom line and estimating their projected liabilities, they had to quickly adjust their calculations in response to the cuts and deferral to allow them to capitalise on the benefits of both. Consequently, many businesses have become aware of the need for software that can provide them with real-time visibility of the performance of the business and enable them to make adjustments to the percentage rate and payment plan quickly and easily.

Demand for more responsive solutions has, in turn, fuelled innovation. Estimates suggest that technology saw a rapid acceleration during 2020, achieving three years' worth of growth in the space of nine months. Tax technology has also benefited. The delay to the MTD deadline, coupled with demands for greater functionality, have seen MTD software incorporate much more functionality, adding new features such as anomaly detection, error correction and data analytics.

On reflection

Attitudes towards the digital links mandate reveal that many would have struggled to meet the original deadline. Our extensive research around MTD reveals that while organisations recognise the benefits associated with automation, they curtailed their ambitions and prioritised compliance. Surveys of the readership of Accountancy Age, Tax Journal and Taxation magazine conducted in Q1 2020 revealed:

Tax teams were continuing to spend vast amounts of time on their VAT returns, even after MTD phase 1

63% lacked confidence in the accuracy of their VAT reporting

38% were spending more than 25 days a year preparing and filing VAT data, with 20% spending in excess of 50 days per year

78% were concerned about how they would carry out adjustments and amendments under digital links

Some were ill prepared to make the shift to digital links

27% did not understand the requirements

15% were unaware the deadline also signified the end of the soft-landing period and would leave them exposed to being penalised for non-compliance

62% were not digital links compliant and 40% were unsure which solution to use

84% said they had concerns about the risks associated with spreadsheets

25% thought their solutions would not scale to meet future MTD demands ie demands for supplementary data or MTD for Corporation Tax

Others see MTD and digitalisation as an opportunity

31% perceive MTD as a catalyst for change across the organisation

72% believe MTD will reduce errors, improve accuracy and increase efficiency

68% foresee it will free up staff time or allow them to refocus advisors away from compliance-based tasks

The good news is that there is now much more awareness of the benefits associated with automation and that the delay to the digital links mandate has created the breathing space needed to visualise and achieve these goals. This means MTD can finally realise its full potential as the catalyst for the wider digital transformation of the tax function, as suggested by HMRC, which has stated that "MTD has merely been the catalyst for a business to consider its wider approach to technology and how it can harness it to drive profits and growth".

The appliance of digital links is the last piece of the puzzle for MTD for VAT but it's the first step on the journey to achieving this wider ambition of an automated tax function. MTD will see the creation of an end-to-end tax process for the first time and a blueprint for HMRC to use when it decides to digitalise other tax regimes in the future i.e. income tax and corporation tax. MTD for VAT really signifies the beginning of the automation of the entire tax regime.

Phase 2: the practical implications

To understand the requirements under MTD for VAT Phase 2 we need to look at what HMRC means by a digital link and a digital record both of which will now be brought into the reporting process.

HMRC defines a digital link as the "transfer or exchange of data between software programs, products or applications" in VAT Notice 700/22[3]. This can be interpreted quite loosely which is why the tax authority gives a number of compliance options such as linking the cells between spreadsheets, upload/download of data, automated data transfer and email or portable device.

Digital linking essentially means a digital connection needs to be created between the digital records and the Return and between the Return and HMRC to create a digital chain.

However, as HMRC explains, "any further transfer, recapture or modification of that data must be done using digital links" which means links can come in during the process.

For example, data can be added into the chain digitally during the process, so that calculations, adjustments or amendments can, if need be, be made outside the process and factored back in.

Needless to say, this does have its drawbacks. It creates further complexity and, because it sees manual computations performed outside the process, increases the risk of error.

HMRC goes on to state that "each piece of software must be digitally linked to other pieces of software to create the digital journey". This "digital journey" is in fact a digital audit trail that reveals a clear unbroken passage from the digital record through to the VAT Return numbers that are then submitted to HMRC. This audit trail will be essential in proving compliance with the digital links mandate so it's in your interests to minimise complexity during the process thereby preserving the digital chain.

HMRC Digital Link Definition:

the "*data transfer or exchange within and between software programs, applications or products that make up functional compatible software [and these] must be digital where the information continues to form part of the digital records*".

[3] VAT Notice 700/22, Oct 2019, HMRC, *https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat/vat-notice-70022-making-tax-digital-for-vat*
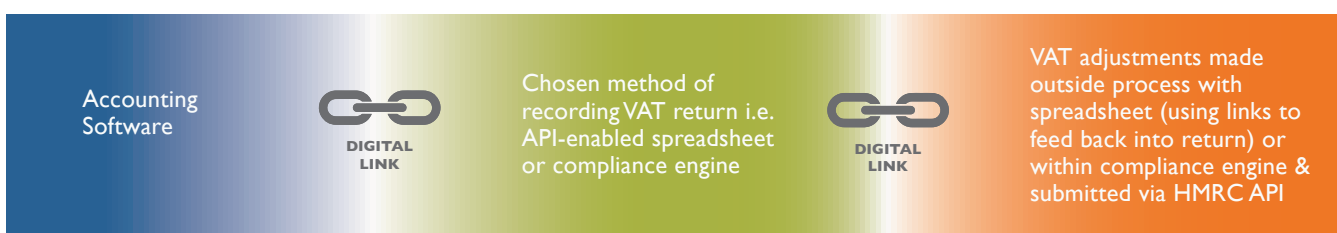
MTD – Reporting before and after

Before: A simplified version of the pre-MTD reporting process is shown in the diagram below:

| Accounting Software | → MANUAL INPUT → | VAT report Copy data from VAT report into Excel & make manual adjustments | → MANUAL INPUT → | Log into HMRC Portal & manually key in boxes 1-9 on the VAT return and submit |

After: With the introduction of digital links, the process becomes digitalised end-to-end as follows:

| Accounting Software | DIGITAL LINK | Chosen method of recording VAT return i.e. API-enabled spreadsheet or compliance engine | DIGITAL LINK | VAT adjustments made outside process with spreadsheet (using links to feed back into return) or within compliance engine & submitted via HMRC API |

Digital records

To implement digital links, you will need to first ensure the digitalisation of your records. There are three main types of digital records under MTD for VAT:

1. **Permanent data:** i.e. business name, address, VAT registration number, VAT accounting schemes used.
2. **VAT account data:** same as pre-MTD requirements.
3. **Transaction data:** i.e. supplies made and received. You need to digitally record information on the time and value of supply, the rate of VAT charged, and the amount of input tax which can be potentially reclaimed.

Your digital records can be held on multiple systems but must be digitally linked to the MTD software which you put in place in 2019. You should record all of the mandatory details shown in the box opposite within your permanent VAT data..

Additional records, such as invoices, will still need to be kept but it is at the discretion of the business as to whether it does so digitally. It's worth noting that as the requirement is for each 'supply' it is no longer sufficient to simply record invoices as these may contain multiple supplies.

However, if those supplies are in the same VAT period and charged at the same rate of VAT they can be recorded as a single amount.

Other relaxations include:
- Retail scheme users can record Daily Gross Takings rather than recording individual sales
- Flat rate scheme users don't need to record purchases unless they are for capital expenditure on which input tax can be claimed
- Individual petty cash purchases with a VAT-inclusive value below £50 can be amalgamated up to £500 (VAT inclusive).

What digital records do I need to be compliant?

The electronic account must include the following digital records:

- Business name
- Principal place of business
- VAT registration number
- VAT accounting systems
- Supplies made inc time of supply/value of supply (net)/rate of VAT charged
- Supplies received inc time of supply/value of supply/amount of input tax to be claimed
- Reverse charge transactions
- Summary data (of your VAT account).

Some records are excluded i.e. floor space used, stock book, and country information for tour operator supplies.

Timelines

All eligible businesses must now comply with the digital links mandate from April 2021. The timeline for compliance will depend on whether you report monthly or quarterly and if the latter, the stagger you are in.

Filing frequency	Quarterly stagger	First period mandated for digital links
Monthly	N/A	1 April – 30 April 2021
Quarterly	Stagger 1	1 April – 30 June 2021
Quarterly	Stagger 2	1 May – 31 July 2021
Quarterly	Stagger 3	1 June – 31 August 2021

Opportunities under Phase 2

The good news is that the implementation of digital links has the ability to benefit businesses in a number of ways. Yes, mandating automation will force businesses to digitalise processes but it also has the power to transform tax reporting. For this to happen, you need to regard the mandate not merely as a compliance issue but as an opportunity to streamline and improve processes and that means choosing a more advanced form of MTD software. With a basic solution, the capabilities of what can be done are limited and external computation is necessary, but with an advanced solution it's possible to benefit from:

RELIABLE DATA	There's a very real problem today with the quality of data being used for tax purposes. Almost 50%[4] of CFOs have expressed concern over whether financial data is trustworthy and accurate. Digital linking software can help to address this as it provides the opportunity to apply data cleansing and querying prior to submission.
GREATER ACCURACY & FEWER ERRORS	Errors are introduced throughout the process by poor application of formulas, corrupted macros, and inaccurate calculations. Removing manual processing from the equation by automating many of these stages will dramatically reduce the risk of error and improve the accuracy of Returns.
MORE EFFICIENCY	Some of the processes associated with VAT are notoriously complex and can involve multiple spreadsheets and calculations which are then subject to a lengthy review process. Automation can remove the need for spreadsheets entirely, creating less data points and less opportunity for error. This also frees up resource, as less time is spent on review, allowing the tax team to devote more of their time to tax planning.
TIME SAVINGS	The VAT Return process can be laborious, repetitive and time intensive. One of our clients found automating their VAT processes using digital link software would save them 104 days per year.
FUTURE PROOF	Digitalising the VAT process requires processes to be put in place that can scale over time. As the business grows, and its VAT stance becomes more complex, the process and the software needs to be able to accommodate change. This makes it vital that the software provider you choose is committed to supporting the solution. Moreover, the UK government laid out its timetable in its ten year plan to extend MTD to the other taxes so it's worth considering if your vendor has also indicated their intention to support MTD for Corporation Tax in a few years' time.

[4] 'The Future of Financial Reporting Survey 2017', Workday and the Modern Finance Forum, https://www.accountancyage.com/wp- content/uploads/sites/3/2018/02/Workday_ffsn-survey-2017-the- future-of-financial-reporting.pdf   [5] New Business Risk Review rewards those with lower risk, Oct 2019, Tax Systems, https://www.taxsystems.com/new-business-risk-review-rewards-those-lower-risk

How MTD can work for you

MTD presents the business with an opportunity to use technology to create a more accurate and efficient process. There a number of ways in which the software selected can add value to the process.

Error correction

MTD aims to reduce the high error rate associated with tax Returns by minimising the need for human intervention. Yet errors can still occur, either at source or during the process. To spot these, checks and balances need to be performed but this can be a lengthy procedure.

Up to 20% of businesses estimate they spend more than 50 days per year validating data from ERP and accounting systems.

Automating error detection can substantially reduce this burden and improve accuracy by:

- Checking for duplicates and out-of-period transactions to highlight obvious errors
- Highlighting unexpected VAT rates in your transaction data
- Picking out transactions between entities in VAT groups that should be excluded from the return

Anomaly detection

In addition to errors, discrepancies can occur which then affect the accuracy of the final Return. For example, the wrong rate of VAT may have been applied to certain supplies. Using machine learning to detect these variances, the MTD solution can flag the anomaly for investigation prior to calculation and submission. Search criteria might include:

- Duplicates across multiple data sources
- Transactions that fall outside the current reporting period
- Unexpected VAT rates in transaction data (other than 0, 5 or 20%)
- Transactions between entities in VAT groups that should be excluded from the return

Importantly, this allows the user to carry out the type of visual checks that were present before in the manual process over a user friendly dashboard.

Data analytics

Often the tax position of the company is only clear at the close of the Return. It's only after the event that the business is able to understand its financial position. MTD software has the power to change this by providing real-time visibility using data analytics.

Armed with this real-time data, the tax team can monitor the tax stance of the business and use this information to answer any queries from HMRC, thus reducing the risk of an audit which can be a long and costly process.

Data analytics can also be used to slice and dice the data in numerous ways.

Trend analysis, for example, allows the business to look at what has been to help determine what the current Return should look like. Predictive analytics can also be used for forecasting. Examples of how analytics might be applied include:

- Comparisons of current and historic submissions and period-on-period payments, helping the tax team check for unusual deviations/errors
- Data summaries that highlight areas of potential inaccuracy (e.g. blocked, excluded, manual adjustments), allowing these to be removed and the Return recalculated
- Insights to support forecasting, such as forward liability projections
- Validation of data quality and error rates
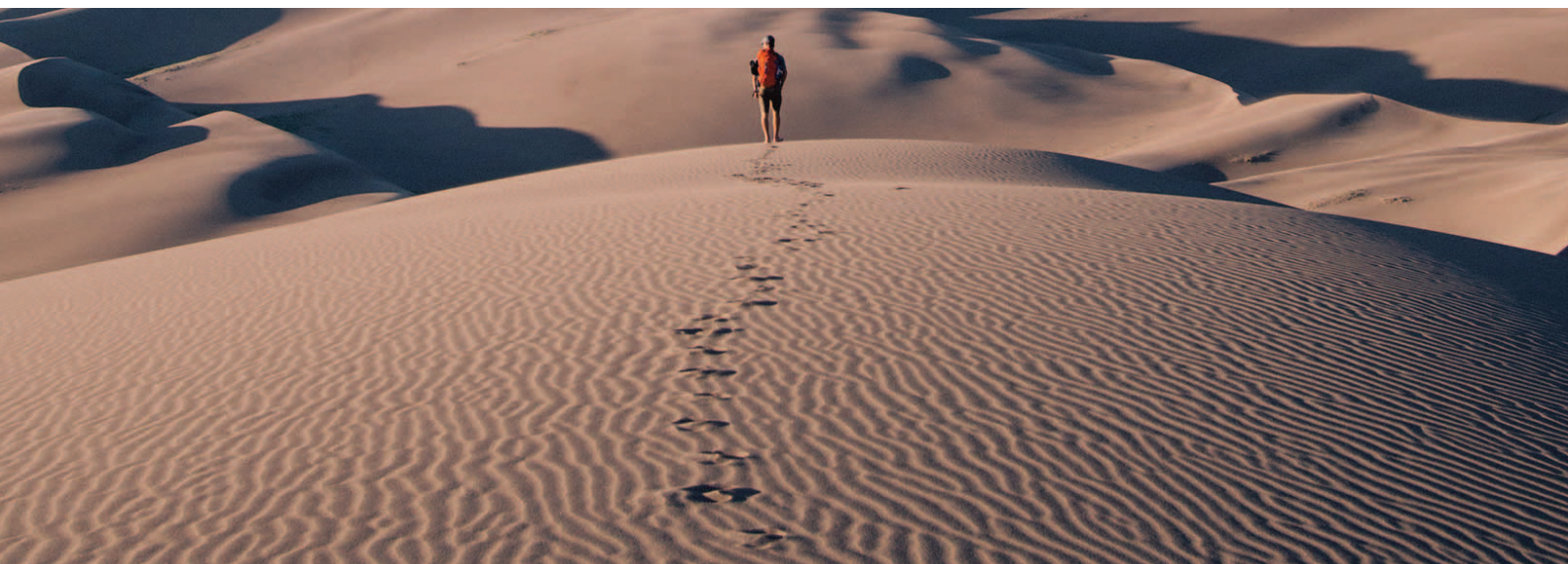
Digital Audit Trail

Using digital links ensures an unbroken digital journey from source to submission. But these links also create a digital audit trail, helping the business to prove its workings and how it arrived at the figures in the Return.

While there is currently no compunction on the business to evidence its calculations today, this may well come in scope as MTD evolves. This is because being able to track back from the results to calculations and their owners and to the source data can dramatically reduce the time taken to satisfy any queries or audit carried out by HMRC.

Being able to evidence your workings is also highly desirable if you use complex methods of calculating VAT such as Partial Exemption or VAT Groups.

With regards to Partial Exemption Special Method (PESM), for example, the business will have been provided with a letter of approval from HMRC stipulating the criteria that can be used to calculate and allocate recoverable VAT. Should HMRC wish to see evidence of how the PESM has been implemented, a digital audit trail can quickly and efficiently reveal how this has been performed.

Larger businesses can also benefit from the digital audit trail by using this to evidence their compliance with the systems and delivery criteria outlined in the Business Risk Review[+].

Things to watch out for!

1. Penalties

The compliance deadline of April 2021 will signify the end of the soft landing period which previously protected businesses from being penalised for non-compliance over digital links. Prior to this, businesses were allowed to copy or cut and paste data from one document to another. This will no longer be permissible once the soft landing period comes to an end. The prospect of penalties under MTD is expected to act as a strong incentive to get the end-to-end digital process right.

During 2020, HMRC is expected to introduce a new points-based system for the late filing and late payment of VAT, as detailed in Finance Bill 2018/19. This will see points handed out for late submission on a cumulative basis. Should a threshold be reached, a penalty will be issued, with every further late filing/payment incurring a penalty.

To wipe the slate clean, the business must have submitted Returns for the past 24 months with the respective number of successive Returns (determined by the filing period) made on time. HMRC already assesses behavioural attitudes to compliance and we can expect this to continue under MTD. HMRC has stated it will expect businesses to make "every effort to comply with the digital links requirement" and could well come down hard on those not regarded as having done so. This could see fines imposed even in cases where correct Returns have been made, if the business has failed to complete these using the correct digital procedures. It's therefore imperative that organisations plan and test their transition to digital linking to minimise the risk of non-compliance and penalties.

Penalty system points for late submissions:

Annual submission: 2 points
Quarterly submission: 4 points
Monthly submission: 5 points

Penalties for late payments:

15 days: no penalty
15-30 days: 50% of HMRC interest rate charge
30 days+: 100% of HMRC interest rate charge plus daily interest

2. Data collection

Data collection is complex because it often comes from a myriad of sources and in different formats. Digital linking will need to be put in place on internal systems i.e. ERP systems but businesses also need to consider external data sources and how they will ensure third party data is MTD compliant.

For example, a VAT group comprising three group member entities will likely have three sources of data, potentially in different formats. This data will need to be digitally linked through to the group VAT Return from each of the three sources, whether this is through the data being collected and fed into the single group Return or whether each member creates a Return which is then linked through to a single group Return.

In either circumstance data has to be collected from multiple sources and digitally links through to the group VAT Return maintained for all data supporting the Return. The increased complexity of data collection and standardisation compounds the probability of errors within this process.

3. Amendments and adjustments

HMRC has clearly stated that manual practices such as 'copy and paste' or the transposition of data from the digital record to the VAT calculation spreadsheet or software will not be permitted. However, as example 7 in VAT Notice 700/22 states, ''As the calculations in the spreadsheet are not required to be kept digitally in functional compatible software, the business can type the adjusted figures into its API accounting software.

However, using a digital link for these processes, rather than a manual transfer, reduces the chance of errors''.

A digital link is therefore preferred to minimise the risk of error and the easiest way of doing this is to make changes within the MTD software itself. To do this, your MTD software needs to feature a closed digital environment where changes can be made prior to submission.

Adjustments need to be recorded in the digital records, but only the total for each adjustment type is needed. At this stage, HMRC does not require details of the calculations that lie behind them and you do not need to adjust the digital record for each supply although this could change in the future.

Manual practices such as 'copy and paste' or the transposition of data from the digital record to the VAT calculation spreadsheet or software **will NOT be permitted**

88%
- of spreadsheets are estimated to be inaccurate due to human error
- Spreadsheets are often highlighted by auditors as a major source of risk
- Using a portable storage device…is also hugely risky

4. Errors and the risk of non-compliance

Spreadsheets are highly prone to error due to the way they evolve over time, resulting in wrongly applied or corrupted formulas, macros or links. 88% of spreadsheets have been shown to have reference errors (where a formula contains one or more incorrect references to other cells). There is a high risk of links becoming broken and macros not being updated to reflect changes in

the source data and or the calculation spreadsheet, resulting in the data being incomplete or out of date. Consequently, spreadsheets are often highlighted by auditors as a major source of risk.

Using a portable storage device as a way to comply with digital links is also hugely risky as the data may become corrupted or fall into the wrong hands. (To help mitigate this risk the data should be encrypted and password protected.)

Mistakes can be costly, incurring penalties and the scrutiny of HMRC, as well as calling into question the systems and processes of the business.

For large organisations, this could increase the Business Risk Review score and trigger a VAT audit.

HMRC has the power to impose penalties should insufficient effort be made to comply with the digital links mandate.

5. Managing the process

Spreadsheet dependency can lead to blind trust in the figures they contain. Checks are seldom made and often can't track data back to source. This is because the data journey is often so convoluted that it simply isn't possible to audit spreadsheets without specialised software.

Managing a multiplicity of bespoke spreadsheets is time-consuming and it's often not clear who is responsible for what.

Often things such as who is responsible for maintaining formulas can fall through the cracks. Even when team members are charged with responsibility for spreadsheet maintenance, this can lead to over-reliance on a small number of key team members (key man dependency), creating issues when that person is unavailable or moves on.

6. The future

HMRC makes no secret of the fact it has ambitions to become one of the most digitally advanced tax administrations in the world and the consensus is that the direction of travel is away from self-assessment towards transparent data access.

HMRC may well seek to emulate the approaches of other tax authorities, such as in Brazil where mandatory electronic invoicing is in place.

Digital linking would be the primary mechanism to facilitate this, giving instantaneous access to invoices as and when created.

Such requirements would effectively render the spreadsheet a redundant part of the process so that in future you would need a dedicated MTD solution in order to carry out amendments and adjustments.

Choices for compliance

So what are the compliance choices that businesses have? HMRC outlines four main choices:

1 SPREADSHEET CELLS	2 IMPORT/EXPORT OR DOWNLOAD /UPLOAD	3 AUTOMATED DATA TRANSFER	4 EMAIL/PORTABLE DEVICE
Data can be transferred between spreadsheets using formulas or macros to link cells. Data is then submitted to HMRC via an API-enabled spreadsheet. It's worth bearing in mind that HMRC acquiesced to demands made by accountancy groups who lobbied hard to ensure spreadsheets were permitted for digital linking under MTD.	Outputting transaction data from source data digital records into a digital format such as XML or CSV. This is then imported into the calculation spreadsheet or software to form a compliant digital link. Similarly, the upload/ downloading of files is also considered acceptable.	Data is transferred between two systems within the business. This means it can be taken direct from accounting/ ERP systems and uploaded into MTD software. Once the digital data is within this compatible software it's possible to make adjustments.	Spreadsheets containing digital records can be sent via email or a portable device such as a memory stick, flash drive etc to a recipient for import into MTD software.

HMRC initially adopted an "anti-spreadsheet stance"[6] according to press reports because the authority wished to reduce the risk of error in the compliance process which spreadsheets are notorious for.

While these options provide the business with a multiplicity of ways to become compliant the range of choices can be confusing. To make an informed decision it is necessary to determine the advantages and disadvantages of each approach.

APPROACH	POSITIVES	NEGATIVES
SPREADSHEET CELLS	+ In common use so readily accessible + Require little specialist knowledge + Easy to manipulate through the application of formulas and macros	– Frequently contain errors through incorrect use of formulas, broken macros or human input error – Grows over time and can become unwieldy to manage – Key man dependency can see knowledge siloed or lost when the person managing them leaves the team
IMPORT /EXPORT OR UPLOAD /DOWNLOAD	+ Conversion of data into accessible formats ie XML or CSV + Can be scheduled	– Makes it difficult to factor in calculations performed externally outside the process
AUTOMATED DATA TRANSFER	+ Allows large volumes of data to be transferred from one system to another + Can be scheduled + Plug-ins provide support for a wide range of accountancy systems	– Makes it difficult to factor in calculations performed externally outside the process
EMAIL/ PORTABLE DEVICE	+ Easy way to send data to external advisers + Require little specialist knowledge to operate	– Can be insecure and risk the loss of data – Difficult to demonstrate a digital audit trail – Limited storage capacity

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[6] Spreadsheets get MTD reprieve?, Sept 2016, Accounting Web, https://www.accountingweb.co.uk/tech/excel/spreadsheets-get-mtd-reprieve

Why a software compliance engine could be the answer

A dedicated software compliance engine is a great choice for MTD compliance and automation. More generally, it straddles several of the approaches suggested by HMRC and avoids many of the risks associated with spreadsheet-based processes.

It provides the ubiquitous access associated with automated data transfer, helping you to integrate with your existing accountancy systems, while utilising import/export to populate the nine boxes of the Return.

Solutions allow data to be mapped directly from ERP and accountancy systems (or can even be taken from a spreadsheet) and imported into the engine where the Return is completed and then submitted via the HMRC API.

Where compliance engines can come into their own is that they provide a dedicated environment in which multiple activities can be undertaken without the need to step outside the process or use other software.

This means complex calculations including group consolidations and partial exemption can be not just completed but automated, further reducing the potential for error. Manual adjustments and amendments can then be made within the solution and are corroborated against past obligations, payments and liabilities to check for anomalies. As tax legislation is embedded in software, compliance engines are kept up to date, ensuring the solution is always up to speed with any regulatory changes.

Compliance engine features will allow the user to:

- **Verify source data:**
  Data mapping and extraction technology is used to collect, prepare, review and check data accuracy, effectively cleansing the data. Large datasets can be consolidated, filtered and interrogated efficiently before being broken out into the correct accounting treatments for the VAT Return
- **Assign access:**
  Role-based access can be applied to folders, entities and groups to assign and log access, eradicating the problem of tracking changes and key man dependency
- **Spot and flag errors:**
  In-built diagnostics advises upon any logical errors. The user can also identify blocked VAT, exclude transactions outside the scope and determine prior Return corrections within the £10,000 limit
- **Automate calculations:**
  Calculations, VAT groups and transactions can be automated.
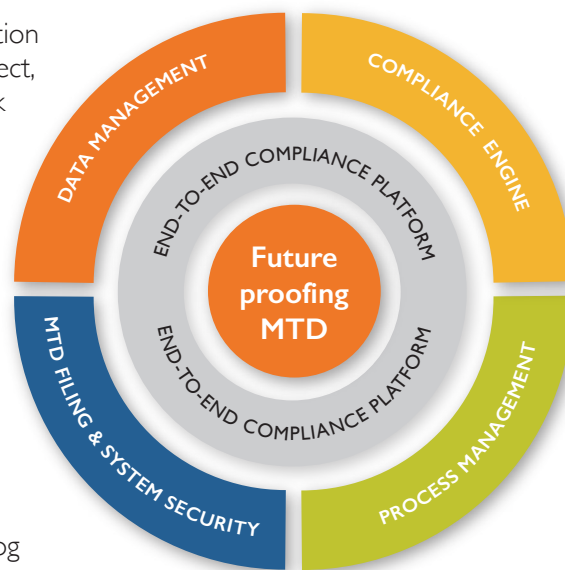
Calculation blocks accommodate numerous treatments from sales and exports, to imports and exports, through to reverse charge calculations. Even PESM can be automated, allowing transactions to be sorted into taxable, exempt and residual categories. Calculation reports allow drill-down analysis to identify the origins of a VAT output and the tracking of historic Returns means payments can be compared to quickly resolve discrepancies

- **Apply amendments/ adjustments:**
  Manual adjustments can be performed within the safety of a sheltered environment without having to worry about breaking the digital link chain. Reports track any necessary data adjustments made before arriving at the final Return values without contravening the digital links requirement
- **View the digital audit trail:**
  Reports track the way data has been sourced and manipulated ensuring a complete digital audit trail. Business Tax Account data can be accessed to create a history of an entity's obligations, submission receipts and VAT Return summaries, ensuring the tax professional has complete visibility
- **Carry out data analysis:**
  Due to the time constraints imposed by routine reporting requirements, there can be limited time to devote to trend analysis and forecasts to help in business planning. However, a compliance engine provides the opportunity to free up key personnel to focus on these higher priority projects.

Conclusion

Putting digital linking in place isn't just about ticking the MTD compliance box for 2021.

VAT impacts the bottom line of the business every day so it's important it is managed effectively. Choosing to comply in a minimal way may make the business compliant but it has the potential to expose it to risk. The risk of error, risk of scrutiny and audit, and the risk of inflexibility so that, in the event of further regulatory change, the business may well need to reinvest in MTD.

Minimal compliance will also fail to deliver on the promise of automation. Creating an end-to-end digital journey can deliver real efficiency gains, helping businesses gain better visibility into and control over processes. Through the application of access controls to prevent data silos and protect confidentiality, the flagging of logical errors and use of in-built tax logic to determine what the best practice process looks like for the business, automation can help make tax reporting more intuitive.

To get to this point, the business needs to assess which of the four compliance methods for digital links, as outlined by HMRC, best suits its needs. It's only by weighing up the pros and cons of each that

a viable futureproof MTD strategy can be determined and suitable solutions investigated.

In our view, spreadsheet use runs counter to the goals behind MTD and the concept of digitalising the tax regime. It sees problems associated with their use, such as the incorrect application of formula and corrupted macros, perpetuated. It fails to deal with the problem of managing and maintaining a multiplicity of spreadsheets and doesn't adequately address how the business can carry out complex adjustments and amendments.

We believe it's inevitable that spreadsheets will be superseded by the software compliance

options for VAT and in the future corporation tax and income tax.

This solution utilises both the automated data transfer and import/export mechanisms suggested by HMRC to deliver digital link compliance but it also goes beyond this, conferring on the business a solution that can automate calculations, flag anomalies and potential errors, and provide help and advice to the user while keeping up-to-date with changes in VAT legislation. In this way the compliance engine doesn't just use digital links to connect disparate parts of the process but ultimately transforms it into a process that contributes to the efficiency of the business.

'Creating an end-to-end digital journey can deliver real efficiency gains, helping businesses gain better visibility into and control over processes'.

AlphaVAT – Tax Systems' compliance option

AlphaVAT is our cloud-based compliance engine that provides total control over the preparation, calculation and management of VAT Returns, including complete visibility of present and past MTD obligations along with payments and liabilities at a group and entity level.

AlphaVAT not only ensures total compliance with the digital submission and digital links requirements of MTD for VAT but also helps improve visibility and control over the tax process. It brings about the transformative benefits associated with the digitalisation of tax, moving the business away from spreadsheet dependency towards an automated process that assists the user.
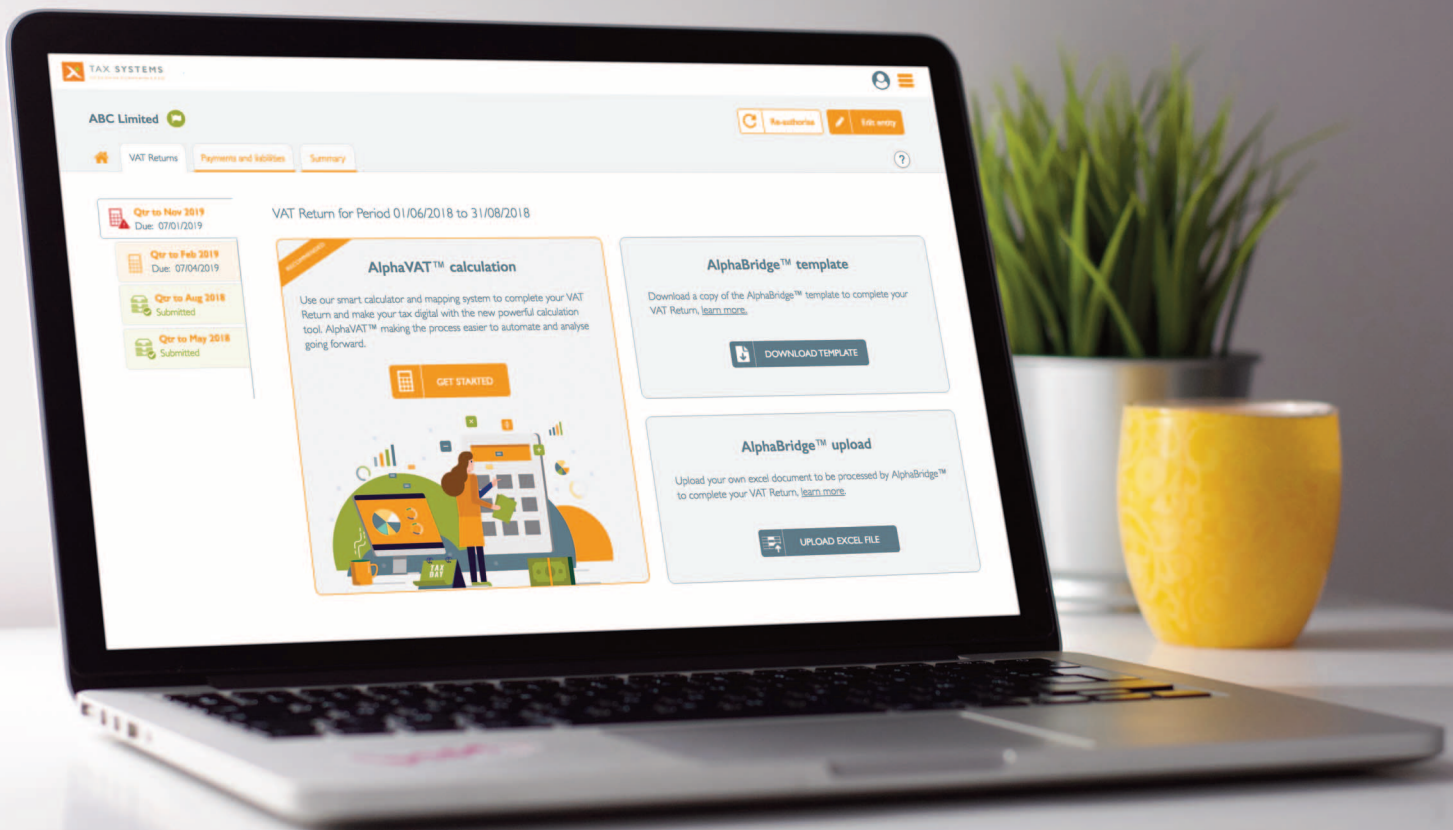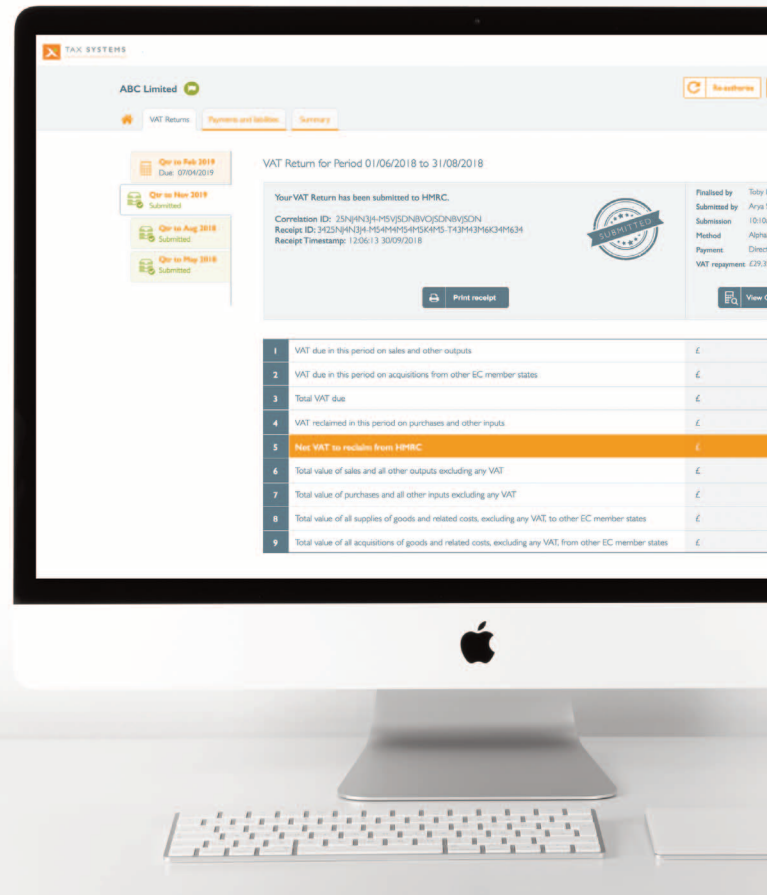
About Tax Systems

Tax Systems is a leading specialist in tax compliance and regulatory reporting technology and services. We provide solutions that enable businesses to automate and manage much of their end-to-end tax compliance processes, reduce their operational risk associated with tax reporting obligations, and build robust audit processes.

Tax Systems is a limited company with offices in London and Dublin. We are the creator of Alphatax, the market leading corporation tax compliance software built over the last 25 years with £60 million in research and development investment.

Alphatax is used by over 1,100 customers including 43% of the UK FTSE 100 and 23 of the top 25 Accountancy firms.

We have been working with HMRC for over 25 years on tax compliance and are a recognised software supplier for MTD for VAT with our AlphaVAT compliance engine solution.

To learn more on MTD for VAT, please visit our **MTD for VAT Resource Centre**.

Or to discuss your MTD requirements telephone **01784 777 700**
or email us at **enquiries@taxsystems.com**

www.taxsystems.com