

EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2021

2021 No. 986

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before the House of Commons by command of Her Majesty.

2. Purpose of the instrument

- 2.1 This instrument amends the Value Added Tax Regulations (SI 1995/2518) (“VAT Regulations”) to extend the scope of an existing requirement to keep digital records and submit Value Added Tax (VAT) returns to HMRC using compatible software, to VAT registered entities with taxable turnover below the VAT registration threshold.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 Not applicable.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the United Kingdom.
4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

- 5.1 As this instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 The vires for this instrument is paragraph 6(5) and (6) of Schedule 11 to the Value Added Tax Act 1994 (“VATA 1994”).
6.2 Section 94 of the Finance Act 2021 made relevant amendments to Schedule 11 to VATA 1994, omitting sub-paragraphs (7) to (9) of paragraph 6. This had the effect of removing a requirement to make an exception in regulations regarding electronic record keeping for taxpayers below the VAT registration threshold.

7. Policy background

What is being done and why?

- 7.1 Since 1 April 2019, VAT-registered businesses with taxable turnover at or above the VAT registration threshold (£85,000) have been required to keep their business

records digitally and provide VAT return information to HMRC through compatible software. This requirement forms part of Making Tax Digital (MTD) for VAT.

- 7.2 The report “Making Tax Digital: An evaluation of the VAT service and update on the Income Tax Service”ⁱ published in March 2020 found that MTD for VAT is operating effectively and that a large number of VAT registered businesses with taxable turnover below the registration threshold have opted to use the service on a voluntary basis.
- 7.3 On 21 July 2020, the government published “Building a trusted, modern tax administration system”ⁱⁱ, which set out a vision for the future of tax administration in the United Kingdom designed to improve its resilience, effectiveness and support for taxpayers.
- 7.4 MTD is a critical building block for this long-term strategy so, as part of the 21 July 2020 announcement, the government also announced the expansion of MTD for VAT to all VAT registered businesses from 1 April 2022. To achieve this policy outcome, the existing exemption based on taxable turnover needs to be removed.
- 7.5 There remain exemptions from MTD for VAT on the grounds of a taxpayer’s religious beliefs, practical inability to use compatible software or when subject to an insolvency procedure.

8. European Union Withdrawal and Future Relationship

- 8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

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

10. Consultation outcome

- 10.1 There has been no consultation on this instrument as only one, technical change to the VAT Regulations is being introduced.

11. Guidance

- 11.1 There is already extensive guidance for taxpayers on gov.uk about MTD for VAT. In addition, VAT Notice 700/22, first published on GOV.UK in July 2018, sets out some additional requirements and provides more technical guidanceⁱⁱⁱ. This guidance has been regularly updated since 2018 and will be updated again after this instrument is made and before it comes into force.

12. Impact

- 12.1 The impact on business, charities or voluntary bodies is that VAT-registered businesses with taxable turnover below the VAT threshold (currently £85,000) will be required to use MTD processes, keeping digital records and using third-party software to submit their tax returns to HMRC. This affects approximately 1.1 million businesses and civil society organisations with VAT obligations.
- 12.2 HMRC expects that businesses will face some costs when moving to and continuing to comply with MTD for VAT, as MTD will change the way many businesses manage their tax affairs. Against this, there will be productivity benefits and cost efficiencies for businesses in going digital.

- 12.3 Businesses within scope that already manage their VAT digitally may incur relatively little cost in moving to MTD. Other, less digitally capable businesses may be more affected by one-off transitional costs as they move to MTD processes. Those moving from paper and spreadsheet-based accounting systems are likely to incur greater cost than those already using software.
- 12.4 HMRC has been working with the software industry to ensure that businesses have access to affordable software products. The industry has produced software at a range of price points and offering different levels of functionality.
- 12.5 Benefits for businesses will come from reducing or eliminating paper-based or manual processes and a more integrated approach to administration and tax, allowing for greater accuracy in tax returns. This will reduce the time businesses spend on tax administration, giving them more time to maximise opportunities and profitability.
- 12.6 The impact on the public sector is that MTD for VAT will reduce the scope for VAT non-compliance resulting from error and failure to take reasonable care. This in turn will contribute to a reduction in the tax gap, thus supporting public services.
- 12.7 A Tax Information and Impact Note covering this instrument was published on 3 March 2021 at Spring Budget 2021 and is available on GOV.UK at <https://www.gov.uk/government/publications/extension-of-making-tax-digital-for-vat/extension-of-making-tax-digital-for-vat>. It remains an accurate summary of the impacts that apply to this instrument.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 13.3 The basis for the final decision on what action to take to assist small businesses was taken following representations about the scope and pace of the rollout of MTD for VAT. In 2017, the government decided smaller VAT registered businesses should have more time to prepare, with an assurance that they would not be brought into MTD for VAT before the system has been shown to work for larger entities. For the reasons set out in section 7 of this explanatory memorandum, the government has determined that now is the right time to extend MTD for VAT to smaller businesses.

14. Monitoring & review

- 14.1 HMRC will monitor the impact of the legislative changes introduced by this instrument on a continuing basis using information collected from its internal systems and processes, as well as regular engagement with affected stakeholder groups.
- 14.2 The instrument does not include a statutory review clause because it relates to tax and therefore meets the requirements of the exemption set out in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

15. Contact

- 15.1 Kamran Quadri at HMRC Telephone: 03000 524463 or email: kamran.quadri@hmrc.gov.uk can be contacted with any queries regarding the instrument.

- 15.2 Anna Thomas, Deputy Director for the Making Tax Digital for Business at HMRC can confirm that this explanatory memorandum meets the required standard.
- 15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this explanatory memorandum meets the required standard.

ⁱ Making Tax Digital: An evaluation of the VAT service and update on the Income Tax Service Budget 2020, March 2020:
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

ⁱⁱ Building a trusted, modern tax administration system, 21 July 2020:
<https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system>

ⁱⁱⁱ <https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat/vat-notice-70022-making-tax-digital-for-vat>.