

# Digital links

What are they and  
are you compliant?



# An introduction to Making Tax Digital

When HMRC first announced Making Tax Digital (MTD), it was a two-phased process. The first phase, scheduled for April 2019, was considered a soft launch. Meaning that businesses, with an annual turnover of £85,000 or more, would need to submit their 9-box VAT returns electronically. Simple enough.

The second phase of MTD, initially scheduled for April 2020 but now delayed until April 2021 due to COVID-19, is more demanding for organisations. What HMRC will be requiring is that if a set of software programs, products or applications are used as **functional compatible software there must be a digital link** between these pieces of software.

## What does HMRC define as functional compatible software?

There is no definitive description of functional compatible software, however, there are 3 characteristics that HMRC have stated make up functional compatible software:

- **Software partners that are HMRC approved**
- **Enabling digital links between accounting systems, Excel and other software**
- **Software that supports your business's way of working and VAT processes**



# Digital links explained

There appears to be some ambiguity about what exactly constitutes a digital link.

In a survey ARKK commissioned in October 2020

# 54%

of respondents were either **'somewhat aware'** or **'not aware at all'** of MTD phase 2 obligations and

# 1 in 5

stated they would have missed the previous MTD phase 2 deadline.

This suggests that roughly **20% of tax specialists** would have missed the original mandate deadline which is a situation no tax professional should be in!

For clarification, a digital link has the following property outlined by HMRC:

**An electronic or digital transfer, or exchange of data between software programs, products or applications.**

This could also include linked cells in a spreadsheet, such as a formula.

# What is **NOT** a digital link?

## Re-entering data

Data can't be entered directly into Excel without supporting evidence behind the record. HMRC's intention with digital links is for companies to have a clear audit trail for tax figures.



## Copy and paste

Sorry, it's time to say goodbye to **Ctrl+C** and **Ctrl+V**. Copy and paste doesn't constitute a digital link and won't be compliant with MTD phase 2 - this also applies to cut and paste!



## Manually typing data

Other than the original creation of VAT records, data shouldn't be keyed directly into your VAT submission.





# What **DOES** constitute a digital link?

There are some obvious, and less obvious, examples of what can be used as a digital link. This may be the cause of some of the confusion.

**The key aim of HMRC is for companies to:**

Demonstrate a clear digital journey from source data to VAT return



Limit human intervention through process automation



Think of digital links as the farm-to-fork concept in agriculture, it seeks to have a clear connection between the source and end product. This ensures that the end user has a level of visibility of the entire process.



# 5 methods that are fully digital link compliant

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## **MTD phase 1 and 2 compliant tax technology**

End-to-end tax solutions that allow VAT data to be imported, adjusted and electronically submitted to HMRC with a full audit trail. Platforms such as for:sight can even check and flag VAT data for inconsistencies.

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## **Application Programming Interface (API) transfer**

Firms can continue using Excel workbooks with an API connection to HMRC for their VAT returns. It should be stated that this method doesn't alleviate the manual, time-consuming nature of Excel data input with the added pressure of potential input errors.

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## **Excel macros and formulas**

Extracting lists of transactions from your accounting system, summarising this into Excel and plugging any gaps using Excel enabled macros.

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## **Robotic Process Automation**

Automating manual tasks in your VAT return preparation using software robotics will comply with the phase 2 mandate.

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## **System integrations (including middleware)**

Passing data between systems using API, XML or EDI.

## 2 additional HMRC approved methods of digital linking

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### Emailing a spreadsheet

It may come as a surprise but it's perfectly acceptable to email a spreadsheet containing digital records so the information can be imported into another piece of software.

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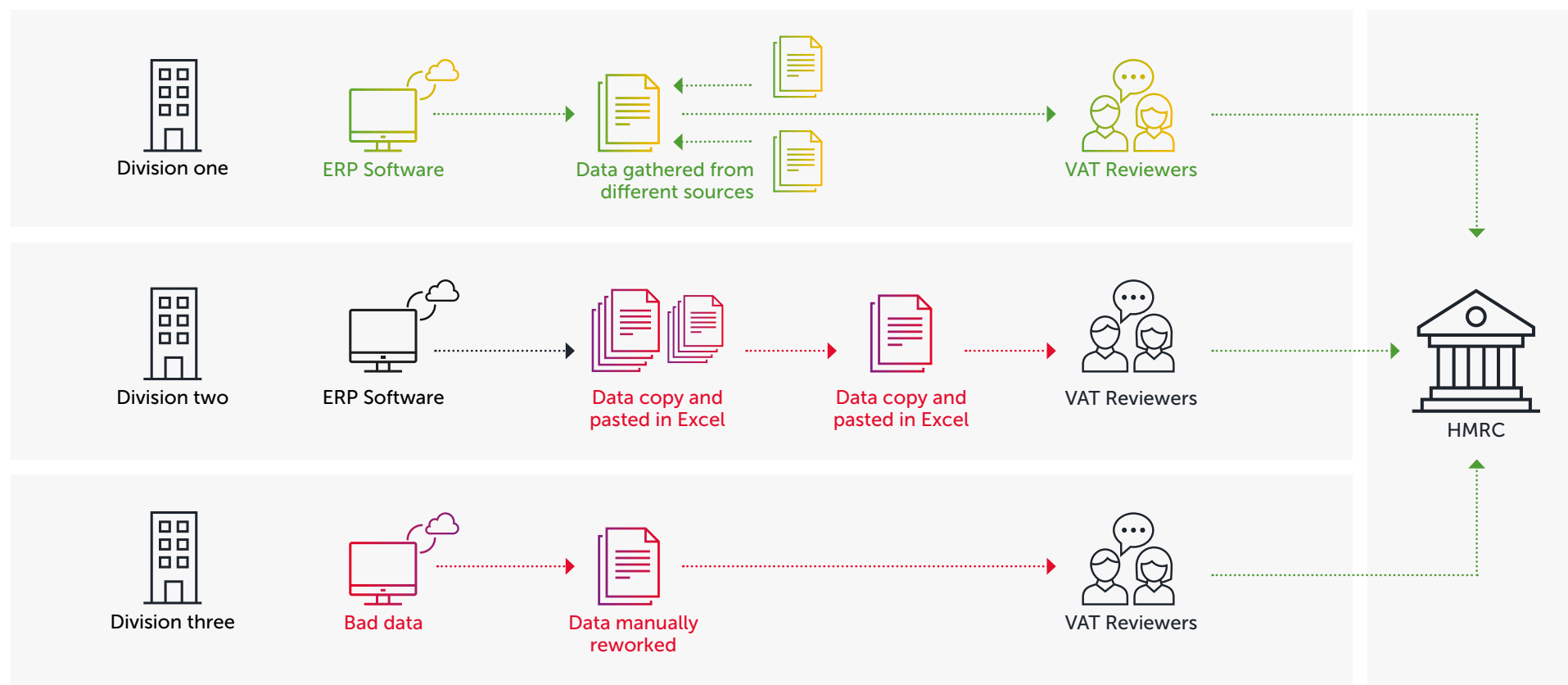
### Transferring records via a portable device

Another acceptable method is to transfer a set of digital records onto a portable device such as a pen drive, memory stick or flash drive and physically give this to someone else who then imports that data into their software.



# Digital links in practice

Below is an illustration of what is and isn't compliant as a digital link. The **green** connections are fully compliant with HMRC's mandate, whereas the connections in **red** fail to demonstrate a clear and full digital audit trail.





# Clarity around calculations

If the adjustment requires a calculation, this calculation doesn't have to be made in functional compatible software. If the calculation is completed **outside of functional compatible software** then **digital links are not required for any information used in the calculation.**

So, with various ways to remain compliant with MTD phase 2 instead of a tax solution – why invest in one?

# Tax technology is about more than just compliance

**HMRC's latest mandate is a fundamental shift for the tax administration and compliance is only the beginning. HMRC has set the ambitious target to "become one of the most digitally advanced tax administrations in the world", MTD is the impetus to help drive this change forward.**

Suitable tax technology will ensure your VAT processes are compliant but what else can your organisation do with this data and technology?

## **Reduce tax preparation time**

Often companies' tax processes are cumbersome and time-consuming, meaning that it can take days or sometimes weeks to compile, prepare and submit VAT returns. A robust tax solution can reduce the time spent on tax returns by between 30-40% allowing the tax function to focus on value-add tasks.

## **Error reduction**

The manual nature of many organisations data entry and review processes can lead to data entry errors. Tax software can automate many of these manual processes helping to minimise the possibility of errors occurring.

## **Greater process control and visibility**

An end-to-end SaaS solution will provide better process control as user permissions and access can be set by management, only giving users the ability to access, review or edit specific data that is relevant to their role. Compiling, preparing and submitting VAT data in one system also means that management have improved visibility of the entire tax process.

## **Better understanding of a company's tax position**

An organisations' tax position is only clear at the moment of close with traditional manual processes, but tax software allows for the possibility of a real-time view. This insight improves stakeholder confidence and provides a more accurate view of a firm's financial health.



## We're here to help

We hope this guide has helped clarify any uncertainty you may have around digital links. If you require any further information around Making Tax Digital or tax software, please get in touch and one of our experts will be in contact.

You can reach us at [arkksolutions.com/contact-us](https://arkksolutions.com/contact-us)