Tolley® CPD

September 2016

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TABLE OF CONTENTS

MAKING TAX DIGITAL

Executive Summary (Lecture B971 – 11.45 minutes)

On 15 August 2016 HMRC released six consultation documents on Making Tax Digital and from 2018 the tax system will become increasingly digital with most businesses, the self-employed and landlords needing to use software or apps to keep their business records and to update HMRC on a quarterly basis.

The underlying tax rules will be simplified to support these changes.

Consultation for corporates will be released later this year.

1. Bringing business tax into a digital age

Digital record keeping and regular updates to HMRC are central to Making Tax Digital. Businesses will be required to update HMRC quarterly with summary data that is uploaded direct from their software or app and then at the end of the year, businesses will have nine months to complete any annual tax adjustments that are needed. Taxpayers will be supported in a number of ways through product guidance, free software, financial support, extra tax relief and training sessions.

Small businesses with gross income of less than £10,000 will be exempt and HMRC are considering deferring implementation by one year for slightly larger businesses.

HMRC want to understand the additional costs that businesses envisage will be incurred.

2. Simplifying tax for unincorporated businesses

There is a general desire to simplify the tax system. There is a proposal to extend the current cash basis threshold from £83,000 to £100,000 or even to double it to £166,000.

Additionally they are looking at reforming the capital v revenue distinction and giving upfront relief for all types of expenditure within the cash basis. Property will be excluded.

3. Simplified cash basis for unincorporated property businesses

Under the proposals, unincorporated landlords would be able to choose the cash basis rather than the accruals basis. There is no turnover restriction.

However, this will not be available to partnerships where they have a corporate partner.

4. Voluntary pay as you go

The current payment dates of 31 January and 31 July will not be altered but quarterly updating will offer the opportunity to pay tax more regularly if preferred.

The consultation considers how taxpayers might make and manage more regular payments and how the payments will be allocated across the taxes.

5. Tax administration

Making tax digital is intended to be easy for taxpayers to understand and give them time to correct matters if need be.

A new penalty regime will be introduced for late filing and late payment and aimed at repeat offended.

- Following a period of grace at the start, late submission penalties will follow a graduated model with each non-deliberate failure attracting penalty points and a penalty being charged once accumulated points reach a level to be decided.
- Late payment penalties will be fair and proportionate with the opportunity to rectify the position before penalties apply

Penalty interest is being considered.

6. Transforming the tax system

HMRC plan to use third party information more effectively by pre-populating the taxpayers Digital Tax Account with payroll information, bank and building society interest as well as other income streams in due course.

Taxpayers will see a complete and up-to date picture of all their tax liabilities in their Digital Tax Account, will be able to update it with any additional income and use their accounts to answer questions about their tax code.

Making Tax Digital is not going to disappear. The scheduled start date is the middle of 2018; April to June 2018 will be the first quarters upload so it is important that our staff and clients are ready for this significant change.

<u>Bringing business tax into the digital age (Lectures B972 – 975: 12.35/19.32/19.49/7.02 minutes)</u>

The plan

The government plan’s to make fundamental changes to the tax system by Making Tax Digital (MTD) by 2020. There is still a lot to design and develop before then and HMRC are keen to work with taxpayers, their agents and software developers, hence the six consultations released on 15 August 2016.

Most businesses, self employed people and landlords will, by 2020, be required to use software or apps to keep their business records digitally and to provide quarterly updates of information.

The transition will commence in 2018, with more and more businesses coming on board so that by 2020 the majority of businesses will be keeping their records and uploading information quarterly on a digital basis.

Each taxpayer will have a Digital Tax Account that will have an up to date picture of their tax affairs that will allow agents to view and manage their clients’ tax affairs in one place.

Businesses that cannot use digital tools will be entirely exempted from these new processes.

Easing the transition to Making Tax Digital

Unincorporated businesses with combined turnover of less than £10,000 will be exempt and the next tier of small unincorporated businesses and landlords will be able to defer the mandatory start of MTD by up to one year.

HMRC recognise that there is a financial cost to taxpayers of MTD and are keen to understand what that cost is. Is it a one-off cost or on-going costs?

They are also considering what support they can offer taxpayers. They are interested in our opinions as to what form that support should take: Financial, tax reliefs etc.

Penalty system

HMRC are looking to introduce a points based system with financial penalties applying after several failures and the treatment of one-off errors will be relaxed as the points built up will be low.

They want to make sure that the transition to the new system is not overly onerous or demanding and so for the first year of MTD there will be a soft-landing on penalties.

Digitally excluded

Taxpayers who are digitally excluded will be exempt from MTD. To be digitally excluded taxpayers will need a very good reason. Religious beliefs, medical conditions or broadband issues will be considered.

There will be exemptions for charities and community amateur sports clubs. However HMRC are hoping that these organisations will see the benefit of the new system and will voluntarily comply with MTD.

Cash basis

HMRC are considering expanding the cash basis of accounting for income tax and that fits well with MTD.

Flexibility

In an attempt to increase flexibility, HMRC are looking to allow tax reliefs, allowances and accounting adjustments quarterly or annually and commercial software will be designed to accommodate both.

Update information

The updates, that will need to be done at least quarterly, will be summaries rather than detailed transactions. The exact format is undecided but is likely to be along the lines of a basic profit and loss account with income and key expense categories.

Simplifying partnership reporting

Under MTD, partnership tax returns are to be abolished. Going forward, partnership accounting software will have the ability to allocate profits to individual partners and upload direct into the individual partner’s Digital Tax Account.

HMRC Case Study – Richard

Self-employed Richard selects, downloads and registers his chosen software and then links it to his Digital Tax Account. He allows key information from his Digital Tax Account to be fed into his software that allows agent access.

At end of the first quarter Richard’s software prompts him to update HMRC.

His software generates his quarterly update from the transactions Richard has entered through the quarter. He (or his agent) checks that the summary is accurate before uploading to HMRC. After submitting the summary he will receive a "successful submission" notice from HMRC.

When looking at his Digital tax account, Richard will now see the quarterly information that he has just uploaded and a running total of tax due based on that information.

At the end of his accounting year Richard asks his agent to finalise his tax and NI position through their agent access to his software. They will check whether the four quarterly uploads are correct for tax and whether there are any further adjustments to make.

Acquiring digital tools

MTD will be mandatory for the majority of businesses with limited exemptions and exceptions. The transition will require taxpayer and agent resource in terms of time and money and that is a major concern.

HMRC will not be providing software. Instead taxpayers will need to buy 'MTD compatible' commercial software, with free commercial software available for the smallest businesses.

Software will need to be capable of capturing and submitting data in specified formats and linking to the relevant Application Programming Interfaces (API) to enable data to be transmitted to HMRC.

Internet access

Clearly, internet access is a pre-requisite of MTD. 90% of premises in the UK have access to superfast broadband (>24 Mbps) and this is expected to increase to 95% by end of 2017. HMRC believe that 2Mbps will be sufficient to send an update so a basic broadband package will be adequate.

The Digital Economy Bill 2016 includes proposals that will give every household and business in the UK a new legal right to request an affordable broadband connection from a designated provider with a minimum speed of 10Mb; plenty for MTD. Areas that currently have limited or no access to broadband should have good broadband access by the time MTD takes effect in 2018.

Commercial software

HMRC are working with commercial software providers to ensure that software will be available to suit the budgets and needs of all businesses including free products from developers!

HMRC will be developing and releasing new APIs to the developers to ensure software is able to communicate with HMRC systems. The aim is to allow many businesses to keep their records and provide regular updates to HMRC with the minimum of assistance so potentially reducing the routine role of the agent.

Software will need to be appropriate to the business need so:

- VAT capability for VAT registered businesses
- Partnership profit allocations for partnerships

There will be substantial testing of software compatibility so that commercial software feeds directly into HMRC systems, using the API, via taxpayers' computers, tablets or smartphones.

HMRC will publish a list of compatible software and will use social networking to provide guidance and assistance.

HMRC case study – Richard

Self-employed Richard selects, downloads and registers his chosen software that prompts him to enter his Gateway login details in order to link the software to his Digital Tax Account.

Richard grants permission for the software to pass his information and data to HMRC and then he is invited to review and update his personal information (UTR, NI number etc). He the selects "Invite accountant" option and enters his agent's details and his agent then receives an automated e-mail notifying her of the registration and invitation to access.

Clearly, HMRC are placing a lot of reliance on software developers and the platforms that they develop to make MTD work effectively.

Digital record keeping

As summary data is uploaded we will still need to retain evidence of transactions and trading including copies of invoices, receipts etc. This evidence could be retained electronically by scanning invoices into software or smartphone apps.

Over time, one could expect such evidence to become digitally based and to evolve into digital invoices captured at point of purchase.

HMRC case study – Eve

Eve has a MTD accounting app on her Smartphone and is able to capture her receipts at point of purchase by taking photos of her receipts that are then captured by her software and invoices are stored electronically on the cloud. Some stores send her electronic invoices that her software is able to capture immediately.

When the invoice is captured in her software, her app populates the amounts recognised from each receipt. She is prompted to confirm that the receipt is for a business purpose and to identify which category of spend this should be allocated to whether that is motor expenses, materials etc. Going forward, future receipts from the same supplier will automatically follow the same categorisation but Eve can select an alternative categorisation if appropriate. Capturing invoices in this way is already possible but will have become a lot more sophisticated by 2018.

Digital record keeping

The software must also be able to deal with any specific requirements of the business such as VAT.

There is likely to be specific buy to let software as it will need to capture:

- Property addresses
- Income and expenses for each property
- CGT information such as the purchase date and amount

Software will enable categorisation of expenditure and will allow tax adjustments to be processed automatically so that:

- Entertaining and depreciation categories will be disallowed
- A private use % will be prompted and then applied to motor expenses
- Capital allowance claims will be automatically prompted and then processed on vans and equipment

HMRC are consulting on categorised headings and are currently suggesting that they resemble the current self assessment SA103F categories: Income, costs of goods, wages, motor, rent, repairs, phone, advertising, interest on bank loans, accountancy and professional fees, depreciation etc.

Prompts and nudges" will allow input from the user or agent where the system picks up something that does not look right or something that needs to be claimed.

Establishing taxable profits

The taxpayer can choose to prepare formal annual accounts if they wish but there will be no requirement under MTD to do so as this new approach wants only regular uploads that are updated for tax purposes.

Remember, quarterly uploads are provisional and must be confirmed at the year-end after any adjustments are made. HMRC would prefer in-year adjustments but there will not be a formal requirement to do.

A lot of adjustments would be easy to make in-year but others like accruals and stock adjustments, may be more appropriate to do at the year end.

Loss relief

Losses will be included in the Digital Tax Account and the accounting software should have the same information. The software will prompt and nudge the taxpayer with loss relief options. Carry forward relief may happen automatically but sideways relief, which requires tax knowledge, will need to be prompted or nudged so that the taxpayer decides, with the help of their agent, how best to claim relief.

Personal allowances

Taxpayers will be given the option to distribute the allowance evenly across the year or including it as a deduction at the start of the year.

Partnerships

Partnership software will allow partner profit allocations with the nominated partner providing regular partnership updates that will feed directly into the individual partners' Digital Tax Account.

By default, there will be no more partnership returns.

Jointly owned property

Landlord software would detail the profit allocation between owners. The nominated owner would upload the quarterly update that would automatically feed the profit allocations into the individuals' Digital Tax Account.

It is likely that there will be an option within the software to override the mandatory 50:50 split for husband and wife.

Construction industry scheme

A contractor's CIS returns will feed directly into the subcontractor's Digital Tax Account. Gross payments and tax deducted would be provided by the contractor's update. All the subcontractor needs to do is check this information for accuracy

Providing HMRC with updates

HMRC have confirmed that the update of income and expenditure will be summary data only that will be automatically tagged by the commercial software using common formats and categories. This could mean the end of the three line account.

The software will be able to calculate profit for Income Tax and NIC purposes and will be effective for VAT purposes where the trader is VAT registered. The need for separate VAT returns will no longer exist.

HMRC will use data to build a better understanding of the business!

Level of detail

As the updates will be covering income tax and VAT, the VAT information will contain more detail than the current VAT return. VAT registered businesses will submit an update that is also a VAT return that will require an additional declaration.

The commercial software will need to be able to cope with special VAT schemes including the flat rate scheme, cash accounting and the margin schemes and could also cover EC Sales Lists, Intrastats, Reverse charge sales lists etc.

Time periods and time limits

Updates must be at least quarterly but could be made more frequently if preferred, enabling monthly VAT traders to continue with monthly submissions.

Most businesses are expected to submit quarterly updates on a calendar quarter basis but the business will be able to choose their update cycle.

Assuming that the trader is up to date with their entries, the update process should be achieved by simply pressing a button once a quarter. As part of the update the taxpayer will confirm that the period's data is complete to the best of their knowledge. It will be important for clients to stay up to date.

As the upload process is so simple the submission deadline is likely to be one month following the end of each update cycle, shortening the current VAT submission deadline by 7 days but not necessarily changing the current VAT payment deadlines.

Ensuring good compliance

HMRC are planning to use "prompts and nudges" as part of the update process to help identify possible problems with the data. Businesses will have the option of revising or correcting any problems identified before they finalise their update.

HMRC will maintain their existing level of compliance powers but expect it to be more focused. A "soft landing" approach is expected in the early stages of MTD, maybe for the first year.

Cumulative picture

Once a quarterly summary is uploaded the Digital Tax Account will show the taxpayer's cumulative position including an accurate estimate of the tax and NIC that is due. Taxpayers should get a clear picture of how they are doing and how much tax, NI and VAT is due.

Starting to update HMRC

Businesses will begin to fall within MTD for income tax and NI purposes from April 2018 with VAT coming within MTD from April 2019.

The update cycle will not alter the income tax year which will still be 6 April to 5 April.

So when do businesses start quarterly uploading?

Option 1

MTD could commence on the first day after the accounting period ending in 2018/19.

A taxpayer with a year end of 31 August 2018 would be within MTD from 1 September 2018. Their first update would be for quarter to 30 November 2018 that must be submitted by 31 December 2018. A Self Assessment return (SAR) would be required for 2018/19 as the taxpayer is not fully compliant with MTD until 2019/20. This return would be submitted via the Digital Tax Account. A SAR would not be required for 2019/20 as the Digital Tax Account would have all the required information.

Taxpayers that align their year end with the tax year would have their first quarterly upload to 5 July 2018 with no SAR needed for 2018/19.

HMRC policy of treating 31 March year ends as aligning with the tax year is likely to continue under MTD with the quarter to 30 June 2018 being their first upload.

Option 2

Under Option 1 a taxpayer with a 28 February year end would not come into MTD until 1 March 2019.

Under Option 2 the first quarterly upload is accelerated to be the first quarter falling wholly within 2018/19.

A taxpayer with an accounting date of 28 February 2018 has quarterly dates of 31 May, 31 August, 30 November and 28 February. The first quarter falling wholly within 2018/19 is the quarter to 31 August 2018 and that will be the first quarter of upload. A SAR would still be required for 2018/19 as no data would be held for March 2018 to 31 May 2018.

Option 3

Although contained within the consultation document, this option seems least likely.

VAT comes within MTD from April 2019 so for the first year of MTD a separate VAT return will be required. To ease the eventual transition traders could choose to align their quarterly update periods with their VAT periods.

Their first quarterly upload in 2018/19 could be the first VAT quarter wholly within 2018/19.

When they enter 2019/20 they only one upload will be required for VAT and Income Tax purposes.

Option 3 is probably a non-starter as most businesses should be looking to align their VAT periods with their accounting periods under MTD.

Practitioners' workload

Most unincorporated businesses will have a 31 March year end. Will this create quarterly workload issues for accountants?

We should aim to migrate businesses to cloud based accounting software a year before MTD commences so for the year ended 31 March 2018.

Use this period to ensure that clients are comfortable with the software and that, as their agent, you get into habit of reviewing client data monthly. Doing this will ensure that when you come to a quarter end, you have already reviewed the previous two months data and only have one month of data to check before uploading.

If reviewing monthly does thus create fee restraints? It is important to use the software effectively on a regular basis and look to provide value added advice. Although there will be regular checking of quarterly data, there will be no SAR, VAT return or partnership return.

Crystallising the liability

For those that use the cash basis for income tax the quarterly uploads should be reasonably accurate. Finalising their tax position will be as simple as confirming their updates are complete and making a "complete and accurate" declaration. Assuming they have no other income, this declaration will then crystallise their tax liability for the tax year

End of year activity

Those businesses that need to make adjustments before making their declaration will have the ability to do so as an "End of year activity" adjustment. This will include adjustments like accruals, stock adjustments and sideways loss relief claims.

HMRC are proposing a 9-month deadline for these adjustments from the end of their accounting year to adjust/declare.

There is a separate consultation on any further adjustments that are needed after the 'end of year activity' adjustments.

Exemptions

All businesses with income tax, national insurance, VAT or corporation tax obligations will be within MTD unless they have been specifically exempted.

MTD will be voluntary for charities and CASCs although HMRC are hopeful they will comply.

Those who cannot engage digitally

There is an existing exemption from online VAT filing for those that cannot engage digitally.

This includes persons:

- who the Commissioners are satisfied is a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications; and
- for whom online filing is not reasonably practical for reasons of disability, age, remoteness of location, or any other reason

HMRC are consulting on whether this should be applied to MTD generally.

Those that cannot digitally engage will be exempted from MTD and there will be no requirement to maintain digital records or quarterly upload.

Businesses with income below £10,000

All unincorporated businesses with annual income (turnover) below £10,000 will be exempted from MTD. However, this exemption will not apply to corporates, LLPs or partnerships with a corporate partner.

Taxpayers will need to consider their total income from all of their business income streams so business turnover and buy to let income. However salaries and pensions are not included in the threshold test.

Deferring MTD for smallest businesses

HMRC propose to defer the introduction of MTD by one year for the next tier of small businesses. As yet, who is included in that next tier is undecided and they are consulting on what the next tier should be.

Simplifying tax for unincorporated businesses (Lecture P971 – 13.14 minutes)

Cash accounting entry threshold

Currently, over one million unincorporated businesses use cash accounting for income tax and national insurance purposes.

To be eligible unincorporated businesses must have turnover below the VAT registration threshold of £83,000 or double that limit for self employed claimants who are on Universal Credit.

HMRC are consulting on whether the entry thresholds should be increased and if so to what amount. If it were increased to £166,000 a further 175,000 businesses would become eligible for cash accounting.

The exit thresholds are likely to remain at twice the entry thresholds.

Reforming basis periods

HMRC want more flexibility and less complexity within the tax system. At present, the current year basis does not provide sufficient flexibility to fit with Digital Tax Accounts and their aim is to simplify the basis period rules and eliminate the overlap period.

Accounting periods

Businesses will be able to choose an accounting period.

The system could be based on the corporate definition of an accounting period such that: a period

- begins when the trader commences trading or after the end of previous accounting period.
- ends on the earliest of next accounting period date, 12 months or on cessation of trade

Taxable profits would then be those falling into the accounting period ending in the tax year so current year basis but without the complications of opening year, overlap, change of accounting date rules.

Established businesses would still be able to relieve overlap profits on cessation of their trade.

Example 4 – David

David is a self employed florist who has an accounting year of 31 December and he uses the cash basis.

He struggles in the early days of Making Tax Digital (MTD) as his 31 December year end confuses him as he uploads quarterly but his 2019/20 Digital Tax Account is based on results to 31 December 2019.

Under MTD David prefers to have an accounting date for each quarterly upload in 2020.

- The quarter to 31 March 2020 is added to the 2019/20 Digital Tax Account which is another accounting period ending in 2019/20.
- The four quarters to 31 March 2021 form the basis of his Digital Tax Account for 2020/21 and now it makes sense!

Simpler business reporting

HMRC want to reduce the burden in calculating profits for unincorporated businesses. Currently those businesses that do not adopt cash accounting for income tax must follow GAAP.

HMRC are consulting on a reduced version of GAAP for calculating profit for tax purposes. The aim would be to have fewer adjustments than would be required under GAAP so more like a TAAP!

If accounts are needed for other purposes then GAAP should be followed

TAAP specifics

Some of the ideas that are being considered are:

- Not valuing closing stock at all
- Contracts < 12 months not being apportioned on an “earned” basis
- Only writing off a debt when recovery action has failed
- Ignoring accruals; expenses and income recognised when invoiced

Capital and revenue divide

Under the cash basis a deduction is allowed for capital items if they would have qualified for capital allowances under ordinary tax rules but this rules requires tax knowledge.

HMRC want to simplify this so that relief is available for short term spend on depreciating assets. Assets which are not used up in the business over a limited period continue to be disallowed and would include items like:

- Property,
- Intangibles > 20 year life,
- Goodwill

The consultation does not cover the position for cars.

Simplified cash basis for unincorporated property business (Lecture P972 – 6.38 minutes)

Introduction

The cash basis for income tax is currently available to unincorporated traders with turnover under £83,000 or under £166,000 if Universal Credits is claimed. HMRC are consulting on whether to extend cash accounting to unincorporated landlords but no turnover restriction is envisaged.

A significant proportion of individuals who complete annual tax returns operate unincorporated property businesses; two thirds of these have just one property and most of the rest have five or fewer properties. It is estimated that the cash basis would benefit 2.5 million unincorporated landlord, simplifying their Making Tax Digital (MTD) obligations.

However, the cash basis would be optional as some may prefer the accruals basis

What is the cash basis?

Under the cash basis, landlords would recognise rent when it is received and costs when paid. Expenditure must be incurred wholly and exclusively incurred for the letting business with capital expenditure being recognised as a cost when spent but still on a renewals basis for residential property.

The £500 interest restriction would not apply to commercial properties or FHLs. Interest would be deductible if wholly and exclusively incurred and from April 2017, interest on residential properties would be given as a 20% tax reducer.

Excess payments (losses) are simply carried forward with no sideways offset

Scope

The cash basis would only be available to individuals and partnerships and the partners must all be individuals. This would extend to non-resident individuals or partnerships but companies, LLPs, mixed partnerships and trusts would not be eligible for cash accounting.

Where property is jointly owned, each owner would be able to make their own decision on whether to adopt cash accounting or stay with the accruals basis but presumably both would reach same conclusion!

Cash basis could cover commercial, residential and FHLs

Security deposits

Security deposits are a cash receipt and should be included as income and where the deposits are handed over to the tenancy deposit scheme that would be an expense. If landlords hold the deposit themselves then the expense is deferred until the end of the tenancy

Voluntary pay as you go (PAYG) (Lecture P973 – 12.56 minutes)

Introduction

Under voluntary PAYG the due dates for payment will remain as 31 January and 31 July with payments on account calculated as 50% of the prior year liability. The Digital Tax Account will however show the tax accruing at the end of each quarterly upload on a cumulative basis.

From April 2018 MTD will have a voluntary PAYG facility for income tax/national insurance/CGT that will be extended to include VAT from April 2019 and corporation tax from April 2020.

The consultation looks at…

- How taxpayers might make and manage their voluntary payments
- How the voluntary payments will be allocated across the taxes, and
- How voluntary payments can be repaid if the taxpayers circumstances changes

How will it work?

The taxpayer will decide if and when they want to make any voluntary PAYG payments and will also decide how much they want to pay. When uploading each quarterly summary, the taxpayer will be asked whether they want to make a voluntary payment but voluntary payments can be made at any time

Voluntary payments will appear on the taxpayer's digital tax account as a credit that will be allocated against tax liabilities as they become due or in MTD terminology, as they "crystallise". Any unused credits can be carried forward or repaid.

What will the Digital Tax Account look like?

The exact design of the Digital Tax Account has not yet been finalised but it will clearly show:

- Quarterly updates (profit and tax accruing)
- Crystallised liabilities (31 January and 31 July)
- Voluntary payments as credits until they are allocated to a crystallised liability

HMRC are considering a period of grace before setting a credit against a crystallising liability in case the taxpayer decides to settle the crystallising liability separately.

What happens when VAT comes within Making Tax Digital (MTD)

Once the quarterly summary is uploaded, the Digital Tax Account will show the VAT and income tax/NIC accruing as separate figures.

The VAT liability will continue to be due on 7th and any voluntary payments will be set against the crystallising VAT liability on that date.

Whenever a liability crystallises, the voluntary payments will be allocated to that liability. Additionally, HMRC are considering what set-off rules to apply when voluntary payments do not cover crystallising liabilities.

Repayment of voluntary payments

Taxpayers' circumstances may change so HMRC want to automate the repayment of voluntary payments.

Taxpayers should be able to request a repayment of all or part of their credits. However, they are consulting on whether this should be restricted to the excess over an imminent liability say within 30 days.

Other aspects of PAYG

Quarterly uploads mean information is more up to date so should the payments on account system be revised?

Overpayments are currently repaid automatically but a taxpayer can elect for it to be treated as a voluntary payment

Interest will accrue on under- and over-payments of crystallised tax and NIC and credits will not be treated as overpayments

Partnerships may settle partners tax liabilities and third party payments will be possible

Tax Administration (Lecture P974 – 12.24 minutes)

This fifth consultation document on Making Tax Digital covers four main areas:

1. Compliance
2. Late submission penalties
3. Late payment sanctions
4. Interest alignment across taxes

Compliance powers

Under MTD, HMRC expect fewer compliance interventions. Nudges and prompts will alert taxpayer's to common errors, inconsistencies or missing information so allowing taxpayers time to correct them.

The consultation is more about adapting existing powers than extending them.

There are no proposals to introduce HMRC enquiry powers on the in-year quarterly updates so enquiries will be focused on the position after the End of Year Declaration with the same 12-month window as at present.

There will be determinations where no Declarations are made.

Late submission penalties

Late submission of quarterly updates and End of Year Declarations would be subject to new penalty rules. From April 2019 each late submission would attract penalty points with fixed penalties applying once accumulated points reach a certain level. At present there are no details on the fixed amount of the penalty.

The current inaccuracy penalties would continue to apply (Schedule 24, FA 2007).

The consultation outlines how the points based system for non-deliberate late submissions might work with deliberate failures having stronger sanctions.

Model 1 – Basic model

The basic model is favoured by HMRC due to its simplicity and would work as follows:

- One or more penalty points for each late submission
- Penalties charged when four points have been accrued
- Once penalties commence further late submissions would have an immediate penalty
- The points total would be re-set to zero once the taxpayer has achieved 24 months of compliance with their submission obligations
- The Digital Tax Account would show the points accrued to date

This model should work for monthly, quarterly and annual obligations and for information only obligations (EC Sales Lists etc).

Late payment sanctions

Payments obligations will be distinct and separate from submission obligations and will have a separate penalty system as a points based system was not considered appropriate for late payments.

There are two proposals for late payment penalties:

1. Penalty interest when more than 14 days late
2. Revision and alignment of the existing regime (Model 1 and Model 2)

Penalty interest

This would be in addition to the interest charged on late payment and would be charged at commercial borrowing rates (HMRC suggest 10%). This approach allows for differentials between degrees of lateness (one day v one month).

The penalty interest would not be tax deductible and it is believed that it will incentivise prompt payment.

Revising and aligning – Model 1

Introduce one common system for income tax, VAT and corporation tax which is broadly based on the current income tax system.

It could be:

- 5% when 30 days late,
- another 5% when 6 months late, and
- another 5% when 12 months late.

It could be amended for more regular obligations such as VAT so:

- 3% when 30 days late, and
- another 3% when 60 days late.

Revising and aligning – Model 2

Model 2 is similar but uses a tapered system where the late penalty percentage increases the longer the debt is outstanding.

It could be:

- 4% when 30 days late,
- another 10% when 6 months late, and
- another 15% when 12 months late.

It could be amended for more regular obligations such as VAT:

- 3% when 30 days late, and
- another 10% when 60 days late.

Which of the three options is chosen has yet to be decided.

Late payment interest

Interest on underpayments and overpayments will continue with HMRC looking to align interest regimes across the taxes.

The current income tax and NIC interest rules will continue to apply after April 2018 but they are consulting on how to align income tax, NIC, VAT and corporate tax regimes going forward under Making Tax Digital.

Overall they are looking to implement a system that is simple, easy to understand and is proportionate to the offence.

Transforming tax system through better use of information (Lecture P975 – 12.47 minutes)

Introduction

This consultation focuses on more effective use of third party information. Currently over 10 million taxpayers file a self-assessment return in the main giving HMRC information what they already have.

Under Making Tax Digital HMRC aim to pre-populate the Digital Tax Accounts with information that they already hold such as salary, pensions, bank and building society interest. The taxpayer uploads information that HMRC do not have such as business profits and then the tax due is automatically calculated in the Digital Tax Account. Under this approach, by 2020 there is no need for an annual self-assessment return.

Using third party information better

HMRC have already begun the journey towards digital interaction and many will already find that their Digital Tax Account is a useful tool for:

- Checking income tax estimate and PAYE codes
- Changing address
- Changing company car
- Applying for the married allowance
- Tracking forms…
- Checking national insurance record

By the end of March 2017 HMRC hope to have 7 million taxpayers using their Digital Tax Account.

Over the next two years

In October 2016 tax codes will be amended for prior year taxable interest although 95% of taxpayers do not pay tax on interest.

From April 2017 HMRC will start to use PAYE information during the tax year to calculate whether the right tax is being paid and notification will be via the Digital Tax Account when this is not the case.

From April 2018 bank and building society interest to be pre-populated and taxpayers will receive alerts where tax is due.

PAYE codes will be automatically adjusted and MTD exempt taxpayers will be able to opt into quarterly updating.

Information standards and security

HMRC are setting themselves data standards and are working with third parties to ensure accuracy of information.

HMRC will show all the information they are using to calculate an individuals tax liability with sources of income being shown separately so that taxpayers can check it easily. HMRC will assume joint held assets are held in equal shares.

Taxpayer confidentiality will be a high priority.

HMRC will offer a digital query resolution service as well as other alternatives.

Conclusion

Making Tax Digital will happen and practitioners need to start addressing the changes as soon as possible by communicating with clients to outline the changes and ensuring that that they are considering the optimum way forward in terms of software to use and when to comply.

It is worth spending the next few months researching software and decide:

- what cloud based software suits your client base
- how best to train your staff to use the software effectively

Ideally, aim to migrate clients to software for the year to 31 March 2018 and educate clients in keeping their records up to date so that they are ready for MTD the following year.

Remember to review your clients' information regularly and utilise the software to add value to your service. That way, when April 2018 comes along you will be more than ready!