

Making Tax Digital (MTD) for income tax

(Lecture P1229 – 26.18 minutes)

It was announced in the summer of 2020 that MTD roll out would move to income tax from 6 April 2023, and that all businesses and landlords with gross income in excess of £10,000 would be mandated into the new rules from that date. This would mean that landlords will remain in Self Assessment until 2022/23 but would need to keep digital records from 6 April 2023.

Income tax businesses with a 31 March year end would not come within MTD until the accounting period commencing 1 April 2024.

We have a 'roadmap' for these developments, with a proposed pilot commencing April 2022.

How would this work – software issues?

I think that HMRC's expectation is that for income tax the submissions by agents (around 50% of the whole income tax population) would be through tax software, but given the success of VAT reporting capabilities I wonder whether the quarterly submissions might best be made through accounting software such as Xero, or from spreadsheets and similar using bridging software.

It would probably be a small matter for accounting software to make the submissions required for income tax, with the final (period 5) submission being made through tax software, which would also include details of other income and allowables such as pension contributions and gift aid.

HMRC does need to think carefully about how unrepresented taxpayers will be affected by this so that they are not "shut out" of the new system – I believe functionality should be provided through the personal tax account to replicate what would normally be done by the agent using tax software.

The 2016 plans

It is likely that the broad structure of MTD will not change significantly from the plans announced in 2016. And indeed much of the initial infrastructure for MTD has already been built by HMRC in the expectation that it would move ahead at some point.

However, it is also clear that HMRC will be working collaboratively with businesses, agents and representative organisations to develop the system over the next year or so, and try to ensure that it works for everyone.

Bringing business tax into the digital age

The consultation issued in 2016 is the focus of the changes proposed for businesses in terms of record keeping and regular updates to HMRC. This provides a useful check on what a new system for income tax might look like, and the final result is unlikely to differ much from the below.

- Businesses which are not exempt from the requirements will be required to keep digital records;
- Businesses will be required to update HMRC at least quarterly with details of their transactions, using MTD compatible software;
- Annual accounts and tax computations based on them must be finalised within 10 months after the end of the accounting period;
- HMRC will feed back the estimated tax liability based on the submissions made so far in the tax year; taxpayers will be able to choose to pay their tax based on the submissions made;
- Prompts and nudges will be included in MTD compatible software, which will encourage and support taxpayers to file updates on time, and gradually help to eliminate errors in accounting records.

Who is affected?

All income tax businesses and landlords will be affected by the new rules unless they are exempt. The level of gross turnover and/or gross rents for which exemption is provided is £10,000.

This means that businesses and landlords with total income from both sources below that level will not have to keep digital records, nor will they have to update HMRC quarterly. In addition:

- Charities and Community Amateur Sports Clubs will be exempt from the requirements completely;
- There may be other exempt categories of business, which is likely to include some types of unit trust. Trading subsidiaries of charities will not be exempt. It is likely that there will be some form of exemption for insolvent businesses;
- There will be an exemption for businesses “unable to engage digitally”. This will cover the existing exemption from MTD for VAT returns;
- Partnerships will submit updates (and keep records) on a whole firm basis, but updates will be required to identify the share applicable to each partner;
- Trusts, which have rental or trading activities, are subject to the rules. It is likely that very large partnerships will have more time to comply, as HMRC believes that there are complexities that need to be resolved. The same will probably apply to partnerships that include a limited company partner.

Digital records

Affected businesses and landlords will be required to keep digital records. This will mean either using MTD approved accounting software or spreadsheets accompanied by software that together meet the requirements of MTD. HMRC expects business to keep their records as near to real time as possible, but the requirement for quarterly updates means that this will be at a minimum quarterly.

The exact content of the digital records will be determined by secondary legislation (not yet finalised but expected in Spring 2021) but is likely to include enough information to identify the nature of any expenditure, and possibly the supplier and details of income.

It is likely that retailers will be permitted to include their daily till totals rather than individual transactions (as is the case for VAT). This will probably involve:

- Analysis of their transactions in accordance with the categories on the current Self Assessment return, viz:
 - Turnover
 - Other business income
 - Cost of goods bought for resale or goods used
 - Construction industry – payments to subcontractors
 - Wages, salaries and other staff costs
 - Car, van and travel expenses
 - Rent, rates, power and insurance costs
 - Repairs and renewals of property and equipment
 - Phone, fax, stationery and other office costs
 - Advertising and business entertainment costs
 - Interest on bank and other loans
 - Bank, credit card and other financial charges
 - Irrecoverable debts written off
 - Accountancy, legal and other professional fees
 - Depreciation and loss/profit on sale of assets
 - Other business expenses
- Landlords will keep their records in line with the current tax return entries, viz
 - Income, analysed between rents, premiums and reverse premiums
 - Rates, insurance, rent and ground rent
 - Property repairs and maintenance
 - Loan interest and other financial costs
 - Legal, management and other professional fees
 - Costs of services provided, including wages
 - Other allowable property expenses

Where a business is permitted to file the 'three line' details on the current tax return, this is likely to remain, but it will not remove the requirement to keep detailed records as described above.

Landlords are likely to be particularly affected by this requirement as in many areas of the UK the gross rent limit is likely to be exceeded. But my own experience is that landlords dealing with their own tax affairs have very poor records (if any) and are very likely to submit incorrect figures on their Self Assessment returns.

Quarterly updating

Businesses and landlords will be required to submit updates of totals of transactions to HMRC at least once every three months. For businesses with turnover below the VAT limit (currently £85,000) this may be submitted as total income, total expenses and net profit. This does not obviate the need to keep records with more detail, as described above. Larger businesses will submit the analysis shown above.

The time permitted for filing the quarterly updates is one month from the end of the quarter. Businesses are permitted to choose their quarterly filing pattern, and if it is not coterminous with the accounting period end, a further short period will be required.

There is no requirement for the quarterly updates to include accounting adjustments to reflect accruals, prepayments or stock, but these are permitted if the business chooses. It is also possible to record capital allowance claims and other tax adjustments on the quarterly update if desired.

Quarterly submissions are not a return for the purposes of tax and therefore are not subject to any penalty for inaccuracy legislation.

Annual finalisation

Once the final periodic return has been filed, businesses (or their agents) will have to finalise their profits for the accounting period at the earlier of:

- Ten months after the end of the accounting period; or
- 31 January following the year of charge for the profits.

So, for a business with an accounting date of 30 April, the date for finalising the accounting adjustments is 28/29 February. For an accounting date of 30 September, the date is 31 July, and for 31 March it will be 31 January.

Finalisation will require amendments to correct the monthly submissions made, adjustments for accruals and prepayments and stock if necessary and any tax adjustments as normal for the preparation of a self assessment return.

Tax estimates

HMRC intends to provide an estimate of the tax due to date based on the quarterly submissions. In practice this may prove challenging if clients are not very accurate in their record keeping. It may also prompt concern from clients with seasonal businesses when they see a period showing a loss that will eventually be overtaken by profit later in the period. In any event, the question of claiming capital allowances mid year may well prove difficult to manage from a communication viewpoint.

There will not presently be a requirement to make payments based on these estimates, but that is likely to be the direction of travel in the medium term, bringing the payment of tax much closer to the income it relates to, improving Government debt positions and providing for easier collection through earlier intervention.

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