

MTD accounting records (Lecture B1338 – 22.02 minutes)

The legal background

The MTD for Income tax legislation was introduced into Taxes Management Act 1970 by the Finance (No 2) Act 2017. This introduced Schedule A1 which is not currently in force, but which sets out the structure of Making Tax Digital and provides for regulations to be made to secure the detail.

Schedule A1 requires persons within the scope of the legislation (Broadly sole traders and landlords) to 'keep specified information in digital form'. They are also required to retain those digital records for a specified period of time.

To supplement the primary legislation the Regulations – The Income Tax (Digital Requirements) Regulations were issued in September 2021. (SI 2021 No 1076). These provide additional detail on how the broad requirements of Schedule A1 are to be met.

Functional compatible software

The requirement for businesses to keep digital records encompasses the use of 'functional compatible software'. This term was also used in the VAT Regulations, and covers one or more software products but also includes spreadsheets, which when used together provide the following functions:

- The creation of a digital record of transactions;
- The retention of that record for the requisite period required by tax law;
- The submission of quarterly updates and end of period statements to HMRC using API architecture;
- The receipt of information from HMRC relevant to compliance with these processes using API architecture.

The precise content of the digital records in terms of the analysis of transactions will be provided by an 'update notice' which is to be issued under the Regulations, the so called tertiary legislation presently being available in draft form as of summer 2022.

Digital records – specific content

Regulation 6 (SI 2021/1076) provides the skeleton of what information needs to be captured digitally, and it is similar to the VAT rules in providing only a requirement for brief data items as follows :

For each transaction :

- The amount of the transaction
- The date of the transaction (according to the basis used for reporting for income tax purposes – cash accounting or full GAAP accounting under ITTOIA 2005)
- The category into which the transaction falls – this is to be specified in an 'Update notice'.

Timing of digital record keeping

Regulation 5 requires that transactions are entered into the digital records at the earlier of:

- The deadline for submission of the quarterly update, or
- The point at which the quarterly submission is about to be submitted

So, in practice, this allows record keeping to be done at a minimum on a quarterly basis, although many advisers will probably decide that real – time record keeping (or as near to it as possible) will be their preferred solution.

Analysis of transactions

The analysis required for the transaction records are given by the draft Update Notice, which specifies the content of the quarterly updates, which in turn prescribes the analysis in the records. The draft notices provide for the following headings:

Trade

- Income - as follows:
 - Turnover
 - Other business income
- Business expenses as follows:
 - 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

However, the draft notice does permit traders with turnover below the current VAT threshold of £85,000 to provide a simple total of income and expenses with no further analysis.

Property income – UK non FHL

- Income
 - Total rents
 - Other income
 - Tax deducted from rent and other income from property
 - Premiums
 - Reverse premiums and inducements
- Expenses:
 - Rates, insurance, rent and ground rent
 - Property repairs and maintenance
 - Residential property finance costs
 - Non-residential property finance costs
 - Legal, management and other professional fees
 - Costs of services provided, including wages
 - Other allowable property expenses

Again the draft notice provides for total income and total expenses to be shown, but residential finance costs must be separated.

Overseas property income

The categories of expense are the same as for UK property. The income categories are:

- Total rents
- Premiums
- Other receipts

UK Furnished Holiday letting (EEA FHL similar)

- Income
 - Rents received
 - Income from services provided to tenants (not required for EEA FHL)
- Expenses:
 - Rent paid, repairs, insurance and cost of services provided
 - Loan interest and other financial costs
 - Legal, management and other professional fees
 - Other allowable property expenses

Retailers

The draft retail sales notice permits retailers to keep alternative records – showing a daily sales taking records rather than by individual transactions, which matches the requirement for VAT. There is more detail in the draft notice on what is to be included in this amount.

Errors and omissions in digital records

Where there has been an error or omission in the digital records, Reg 17 requires the person to correct the records as soon as possible. When this has happened, if the End of Period Statement (EOPS) has not been filed for the period including that error, the person must include the correction on their next submission of either a quarterly update or EOPS, depending on which is next to be filed.

However, it is now clear that the expectation is that errors will be corrected **within the appropriate quarter's records** rather than within the subsequent quarter. This means that where errors have been corrected, the taxpayer will be required to resubmit the relevant quarter with the updated totals. This is a practical issue which has only just emerged, as the understanding was that the quarterly submissions would be made on a cumulative basis, and would thus 'self-correct' as necessary. Requiring the resubmission of corrected quarters adds quite significantly to the burden imposed by MTD, particularly when the taxpayer is using spreadsheets and bridging software to comply with the requirements.

Practicalities – trades

The headings specified follow exactly the current headings on the SA103 which means that traders with more detailed and sophisticated charts of accounts will need a mapping function to allow the updates to be prepared as required. Other than that, where businesses are using proprietary branded software the requirements should present no problems. There are also a number of products which, while not offering a full ledger based accounting system will allow traders to link their bank account and classify their transactions ready for submission.

The use of spreadsheets by smaller businesses should also not be a particular challenge. Bridging software is currently being developed which will allow a simple spreadsheet with column totals to be used to collate the records, with bridging software used at the end of the quarter to make the submission. It is clear that the spreadsheet and bridging software will be required to use digital links to the data, but this is already an established practice when submitting VAT returns so adds no further complexity for those using this method for filing VAT returns.

Clients with more than one trading activity will be able to use a mix of spreadsheets and accounting products as each trade will be a separate submission on a quarterly basis (and a separate End of Period statement).

Practicalities – property income

The current design of HMRC's system makes compliance for landlords with a variety of sources of property income very challenging.

There must be only two submissions in respect of property income for each quarter – one for UK property, comprising the datasets for FHL and non FHL letting, and one further in respect of overseas property (probably with data sets for each country in which there is a let property to allow for separate recording of foreign taxation suffered). Note that the draft notices do not seem to record the foreign tax suffered on the income, which presumably is submitted at the end of the tax year.

Where there is a joint let, the current HMRC view is that each of the property owners must keep their own records of their share of each transaction; this record will then need to be combined with records of wholly owned properties and other joint lets with other parties to make a single submission.

This means that landlords with a mixed UK portfolio will either have to keep all of their property income records on a single software product or will need to export from various software and spreadsheets to then combine all of their sources of property income into a single submission. It is not presently clear how this can be achieved.

Practicalities – bookkeepers

At present HMRC cannot authorise more than one agent to act for a taxpayer for any single 'head of duty' (tax, such as Income tax). This will produce significant problems under MTD when bookkeepers act for a trader and wish to make submissions in year, but then hand over to an accountant to deal with the End of Period Statement and finalisation of the tax position. There is no technical solution to this issue at present, which has been a feature of HMRC's systems for so long that it is deeply embedded in the operating systems.

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