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Making Tax Digital: how the next step will impact you

Making Tax Digital (MTD) represents a major change to the way businesses interact with HMRC.

The next phase of MTD, affecting VAT, income tax self assessment (ITSA), and corporation tax has now been announced. But while this MTD roadmap is the headline news, its implementation is likely to mean considerable evolution over the years to come. This Briefing guides you through the basics of MTD and the current timetable for rollout.

- 2020 autumn consultation on MTD for corporation tax
- 2021 MTD for VAT digital links necessary
- 2021 MTD for ITSA pilot to expand
- 2022 MTD for VAT mandatory for all VAT-registered businesses
- 2023 MTD for ITSA mandatory for most businesses and landlords.

MTD: the rationale

MTD is at the heart of the vision of a modern, world-class tax system. The government says 'It should be easy for people to pay any tax due, and for the vast majority of people the calculation and payment of tax should be effortless. For the majority of businesses, tax should be straightforward and hard to get wrong. Taxpayers should be able to view their tax position and tell HMRC anything it needs to know through a single online account. A modern digital infrastructure should enable ease of use, transparency and adaptability.'

It's hoped that MTD will also benefit the business world, as commercial software suppliers offer increasingly innovative services, enabling businesses to improve productivity and profitability. From the government's perspective, it expects MTD to minimise inadvertent taxpayer errors, help root out tax avoidance and reduce the tax gap. But many parts of the vision are still aspirational. At its end, HMRC still has to create a single online account. At their end, commercial software developers still have to develop the additional functionality needed to deliver the government vision. MTD will thus mean ongoing change.

MTD: digital records, digital returns

MTD is all about digital record keeping and the digital submission of quarterly returns to HMRC. Businesses already in MTD for VAT (MTDfV) have experience of what's involved. Certain business records have to be kept digitally: specified information then flows to HMRC directly from the records, without manual intervention.

Many taxpayers will be used to filing income tax self assessment or VAT returns online. But MTD isn't the same as simply making an online submission: the software involved has to be MTD functional compatible software. This means it must be able to keep and preserve the records specified in the regulations; prepare the returns required by HMRC; and communicate digitally with HMRC through its Application Programming Interface (API) platform. We cover the specifics for MTD for ITSA in more detail below.

Tip: corporation tax

There isn't a firm start date for MTD for corporation tax yet. Consultation will take place in autumn 2020.

MTD for VAT 2021: digital links

Businesses already mandated into MTDfV should remember that from their first VAT return period beginning on or after 1 April 2021, they must have digital links in place between all parts of their functional compatible software. A digital link is an electronic or digital transfer, or exchange of data, between software programs, products or apps.

The use of cut and paste or copy and paste will no longer be accepted as a digital link from this point. But HMRC will accept the following (and the list is not exhaustive):

- linked cells in spreadsheets
- emailing a spreadsheet containing digital records so the information can be imported into another software product

- transferring a set of digital records onto a portable device (such as a pen drive or memory stick) and physically giving this to someone else, who then imports that data into their software
- XML, CSV import and export, and download and upload of files
- automated data transfer
- API transfer.

MTD for VAT 2022

From April 2022, MTDfV is mandated for all VAT-registered businesses. This means that even voluntarily registered businesses, trading below the current £85,000 compulsory VAT registration threshold, will have to keep the requisite digital records and file digitally. If this affects you, and you would prefer to consider deregistering for VAT, we are happy to discuss this with you. Note, too, that there are some (limited) grounds for exemption from MTDfV. They can be found in section three of the VAT Notice on MTDfV **https://bit.ly/3b63bk4**.

MTD for Income Tax Self Assessment 2023

MTD for ITSA means major change: more involvement with HMRC on an ongoing basis, more deadlines, more filings, and more input from HMRC in return. The yearly timetable will feel very different until the system becomes familiar. And all this despite the fact that the income tax rules themselves, other than those relating to record keeping, aren't changing.

MTD for ITSA will apply to unincorporated businesses and landlords with total annual business or property income above £10,000, for the first accounting period starting on or after 6 April 2023. This will include the self-employed, partnerships and trusts.

Tip: how this will impact you

If you're a business or landlord in MTD for ITSA, you must keep accounting records digitally, using software or a spreadsheet as outlined below. You will then send a summary of business income and expenses to HMRC each quarter. As well as these four quarterly filings, there will be digital end of year finalisation.

Digital record keeping

MTD doesn't mean that businesses will have to scan and store receipts and invoices digitally: though they can choose to do so. And it doesn't necessarily mean eliminating all paper documentation. But there are significant changes. Every transaction will have to be recorded and stored digitally, ideally as close to the transaction date as possible. To do so, you will use MTD for income tax functional compatible software, which can keep and preserve digital records; provide a quarterly update to HMRC; and provide an end of period statement or partnership return. You will be able to use spreadsheets, but, as with MTDfV, they may need to be used in conjunction with bridging software to enable your data to flow to HMRC without manual rekeying. Final confirmation is still awaited, but the draft regulations suggest that the records to be kept digitally will be:

- the amount of the transaction
- the date of the transaction (determined according to whether the business uses cash or accruals accounting)
- the category into which the transaction falls.

There are a number of more complex areas where further clarification will be needed. These include property businesses and retailers. At this stage, it is understood that where there is income from a jointly owned property, each individual will have to keep digital records for their share of income and expenditure, and that retailers may be able to elect to record gross daily takings, rather than individual transactions.

MTD-compatible software for ITSA is listed on gov.uk **https://bit.ly/2FXC3YK**. Products available hitherto have been limited, but the market is now expected to expand. The government has said there will be free software for businesses with the 'simplest' affairs. This won't be provided by HMRC: any such offering will be from commercial suppliers.

Planning point

You may want to start thinking about the record keeping implications of MTD for ITSA now. If you already use software to keep your business records, check with your software provider for MTD compatibility. If you do not yet use software, please do contact us to discuss your next step.

Quarterly digital filing

Quarterly filings will provide fairly basic summary information to HMRC. The full detail is still to be confirmed, but it would seem that the smallest businesses will make a three-line update, comprising income, expenses and profit, and that larger businesses will provide more extensive information based on the categories in the self assessment tax return (SATR). Timing of the quarterly filings will depend on your accounting year end. With a year end of 5 April, the quarters would be:

- 6 April to 5 July
- 6 July to 5 October
- 6 October to 5 January
- 6 January to 5 April.

The window for filing is likely to be between ten days before the end of the quarter (where the filing covers the whole of the quarterly period), to one month after. HMRC will reply to your quarterly filings with in-year estimates of the tax it thinks you are due to pay. It hopes that this will help businesses budget for their tax liability. In reality, these in-year estimates will need significant adjustment at the year end to produce a true picture of your liability (see below).

Finalisation procedure

MTD is publicised as the 'end of the tax return', but the new process will have to cover the same ground as the old, and it's not yet clear quite how this will be done. For everyone, bar those with the simplest tax affairs, and those with 31 March or 5 April year ends, there are likely to be two end of year finalisation procedures:

- finalising business income in a 'declaration'. This will involve making necessary tax and accounting adjustments (capital allowances, accruals and prepayments, for example) to the picture produced by the quarterly filings. The declaration confirms to HMRC that your quarterly filings are correct
- finalising your tax position. This will involve details traditionally included on the SATR, such as other income (savings, dividends, non-trading income, for example), as well as making relevant claims and elections. At present, HMRC is referring to this as a 'final declaration' that will replace the SATR.

Both procedures will need to be completed by 31 January following the end of the relevant tax year. This is the normal SA timetable, and remains unchanged.

Planning point

HMRC's MTD for ITSA pilot is only available to those with very straightforward affairs at present, as outlined here **https://bit.ly/2YKIzZE**. As it expands, you may want to join to trial the system. Please talk to us to decide the best time to do this.

MTD: when you pay tax

At present, the timetable for payment of income tax is unchanged. But with the government pledged to a call for evidence on the timing and frequency of payments, it's clear that payment in real time is its preferred option for the future. We will, of course, update you when the position becomes clearer.

Helping you

MTD for ITSA is not a long way off, and though we don't yet have a date for corporation tax, it's unlikely to be far behind. Whilst the lead-in time looks generous, it will be important to start preparing for quarterly filing and compliance with digital record keeping requirements as soon as possible. Please contact us to discuss the implications for you and your business.