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Making Tax Digital: why it still means big change for you and your business

April 2022 sees the final phase of Making Tax Digital (MTD) for VAT. But that's just the tip of the iceberg. MTD for income tax (MTD ITSA) comes next, and implementation is likely to be altogether more challenging. And then there's corporation tax.

MTD basics

MTD requires individuals and businesses to:

- keep and preserve certain specific business records digitally, in what is known as MTD functional compatible software
- file quarterly updates with HMRC via that software
- complete an end of year finalisation process where relevant.

The hot topic: MTD for income tax

In an unexpected pre-Budget announcement, the government has just set out the final details for the MTD ITSA regime. There is also a new timescale for implementation, allowing an extra year for businesses to get ready for the change. The new timetable should also put HMRC's pilot scheme back on the agenda as a viable option to help businesses prepare in the run-up to mandation.

With the current commercial pressures on businesses, the postponement of a further set of compliance obligations is obviously a welcome development.

But it's only a temporary delay. The Covid-19 emergency has given the government more reason than ever to want the accurate, real-time view of business performance that MTD is designed to provide, and businesses must be ready for the new rules when introduced. MTD ITSA comes underpinned by a new penalty regime, and it will be important to get it right from the outset.

Timetable

Phased implementation: MTD ITSA will be introduced in three stages:

- sole traders and landlords with qualifying income over £10,000 start first
- general partnerships, that is partnerships that only have individuals as partners (rather than, for example, having corporate partners), start a year later
- other types of partnerships will enter MTD ITSA at a date in the future yet to be decided.

Go live dates: for sole traders and landlords with qualifying income over £10,000, the start date is 6 April 2024. This is a year later than had been expected.

For general partnerships, the start date is 6 April 2025.

Earlier guidance had suggested that businesses would enter MTD ITSA for the first accounting period beginning **on or after** the start of the tax year in which MTD ITSA was rolled out. This would have staggered entry to the system, depending on the date of the accounting year end, as entry to MTD for VAT was staggered. This would have meant additional time to prepare for the change.

However, the newly-published regulations make it clear that this will not be the case. For each phase of implementation, all businesses required to enter MTD ITSA will enter together, at the start of the tax year.

Who is affected?

Those with 'qualifying income' over £10,000. This is total income from self-employment and property. In a post-pandemic context, where many businesses have made a loss, it's important to note that the total is *before* deduction of expenses.

Trusts, estates, trustees of registered pension schemes and non-resident companies are not included in MTD ITSA.

There are special provisions for non-UK domiciled individuals.

New businesses will need to join MTD ITSA from the April after the submission of their first self assessment tax return.

What's involved?

Digital record keeping

MTD requires an end to end digital journey. Data flows from each individual business transaction, into the quarterly filing to HMRC, each stage linked digitally, without manual input. Filings themselves pass into HMRC through its application programme interface (API). Where a combination of software products and spreadsheets are used, digital links are needed between them.

There are a number of ways to do this:

- a bespoke software package that keeps digital records and makes your quarterly updates through HMRC's API
- spreadsheets that are API enabled, allowing them to access HMRC systems
- using what's called bridging software. This allows you to use existing accounting software or spreadsheets by bolting on additional software to send data to HMRC through its API.

MTD ITSA may mean you need to make changes to the way records are kept and returns filed with HMRC, choosing new software products. We should be pleased to discuss the best way ahead for your business.

Transactions should be recorded as close to the date of the transaction as possible, and before the quarterly filing for that period. There will be some niche provision for retailers.

More frequent reporting

MTD ITSA means considerably more annual touchpoints with HMRC. The number will depend on income sources and circumstances. For most people, it's likely to bring six points of contact: four quarterly updates plus a year end finalisation process to create what is called an end of period statement (EOPS), to finalise trading/ property income. There is then a final declaration, equivalent to the current self assessment tax return.

Quarterly updates: These are summaries of business income and expenses. Precisely what this involves is yet to be specified. It had been understood previously that only a three-line summary would be required for some smaller businesses, and we shall update you as the position becomes clearer.

When? Quarterly updates will be made either to standard quarters:

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

or, to calendar quarters:

- 1 April to 30 June
- 1 July to 30 September
- 1 October to 31 December
- 1 January to 31 March.

To use calendar quarters, however, you have to apply to HMRC, and there is a deadline for this: the earlier of the time of submission of your first quarterly update, or the date of your first quarterly deadline.

Deadlines for quarterly filing: There is essentially a month to make each quarterly submission. Deadlines are 5 August, 5 November, 5 February and 5 May, and they are the same, regardless of whether you use standard or calendar quarters. Failure to submit by the deadline could mean liability for a late submission penalty.

Tax calculation: HMRC will automatically generate a calculation of how much tax it thinks you owe, based on the information provided in your latest quarterly filing. This however, is likely to need considerable adjustment to constitute a meaningful reflection of liability and we can advise further here.

The end of period statement

The EOPS is based on your accounting period or basis period. It will include the relevant accounting and tax adjustments, such as accruals and prepayments, and claims for capital allowances.

If you have both trading and property income, an EOPS will be needed for each source of income. The deadline for submission of the EOPS is 31 January after the end of the tax year.

Final declaration

This is made after the EOPS. It brings together all sources of income and gains, and makes relevant claims and elections for the tax year. The deadline for submission of the final declaration is 31 January after the end of the tax year.

The bigger picture

To understand MTD, it's important to appreciate the government's ultimate goal in going digital, as well as how plans have changed along the way. The aim, brought sharply into focus by the pandemic, is the ability to monitor business performance in real time. As for change, MTD ITSA was first mooted as making tax easier. It was also going to mean the end of the tax return. Fast forward to 2021, add a pandemic into the equation, and MTD ITSA is no longer likely to equate to either of these things. It is probably fair to say that MTD ITSA in its current form may not be what the business population has been led to expect.

Payment of tax: There's another part of MTD that the pandemic is likely to have spurred on. That's the goal of moving towards payment of tax in real time. In the medium term, it's likely that MTD ITSA will involve quarterly payment of income tax, as well as quarterly filing of income and expenditure data.

It should be emphasised that there is no timetable for the change yet, and the latest MTD ITSA information on gov.uk stresses that the deadlines for payment of income tax are not changing when the rules are introduced.

However, real-time tax payment is the expected direction of government travel: and the logical end point of digital reform. It is as well to be aware of this now, and plan accordingly.

MTD for VAT: what's still to come?

All VAT registered businesses, regardless of turnover, enter MTD for VAT from their first VAT return period starting on or after 1 April 2022.

Also from accounting periods starting on or after 1 April 2022, a new points-based regime applies for penalties and interest. This replaces the VAT default surcharge regime. A similar regime rolls out for MTD ITSA from April 2024.

MTD for corporation tax

HMRC plans to extend MTD to corporation tax, with a view to the rules applying for companies from April 2026. A point to note is that there is no de minimis exemption for smaller businesses. A pilot is expected in April 2024, allowing practice before the system is mandatory. We shall of course, keep you updated as further information is published.

Steps to take now

- Talk to us about the implications of quarterly reporting under MTD ITSA. It is possible that a change of accounting year end may make sense to streamline reporting deadlines.
- Review record keeping and software needs in the light of MTD ITSA.
- Consider how to handle quarterly filings under MTD ITSA: we are happy to act on your behalf if you prefer not to make the updates yourself.

Working with you

The government is committed to the MTD programme, and we strongly advise making preparations now. Please be assured that we are on hand to advise on the best course in your individual circumstances.