BOURNER BULLOCK
Chartered Accountants

114 St Martin's Lane
Covent Garden
London WC2N 4BE
Tel: +44 (0) 20 7240 5821
Fax: +44 (0) 20 7240 5827

Web: www.bournerbullock.co.uk
Email: bb@bournerbullock.co.uk

Making Tax Digital: ready to fly?

Though entry to Making Tax Digital for income tax self assessment (MTD ITSA) is being phased in, the first returns under the new rules are due to be made in 2024. MTD for VAT (MTDfV) already applies to all VAT-registered businesses.

What, however, do the MTD rules mean in practice? HMRC research suggests many people are unsure which developments apply to them. We look here at what's known so far, and what might affect you.

MTD: what are the rules on records and software?

MTD involves keeping and preserving specific accounting records in a prescribed digital format, and transmitting information to HMRC digitally. It does *not* mean having to scan and store receipts and invoices digitally, as originally envisaged.

MTD rules require what is called functional compatible software for record keeping purposes. To make submissions to HMRC, the software is linked with HMRC systems, and there is a specific authorisation process at the outset (and every 18 months thereafter) to do this. The research indicates that some businesses have inadvertently assumed their systems are already MTD-compliant when in fact they are not. MTD is *not* the same as simply using record keeping software, nor filing tax returns online.

The rules require an uninterrupted digital journey to HMRC, information flowing from the accounting records to the digital filing, without manual input. It is understood that, as with VAT, records need not be held in a single software product: where, however, more than one is used, they must be linked digitally, rather than the data being transferred manually between them. Spreadsheets can form a component part of digital record keeping, provided that the product that consolidates records or summary records from the spreadsheet is digital. Summary information must not be physically re-keyed into another software package. We are more than happy to discuss requirements with you.

What happens next?

VAT

- All VAT-registered businesses should now be using MTDfV, whether businesses with taxable turnover over the VAT registration threshold of £85,000, or those operating under this level.
- From 1 November 2022, the online VAT return facility will close. For businesses filing annual VAT returns, the last date to file the old way is 15 May 2023. It will effectively become impossible to file other than via the MTDfV process and those with an exemption will be provided with alternative means.

As the MTD programme evolves, HMRC will be looking to develop its potential. Expert commentators suggest that a move to real-time VAT reporting, with transaction-level detail going to HMRC when transactions take place, is the logical next step. Such real-time reporting is already used in some other countries, and it's worth being aware that this could be HMRC's direction of travel.

Who goes into MTD ITSA – and when?

Exemption from MTD, whether for VAT or ITSA, applies in very limited circumstances only. Broadly, where someone is digitally excluded (the term being defined very exactly) or where there are religious beliefs incompatible with the use of digital technology, or where a business is subject to an insolvency procedure, it is possible to ask HMRC for an exemption.

There are very few exclusions from MTD ITSA. They apply to:

- trustees, including charitable trustees and trustees of non-registered pension schemes
- personal representatives of someone who has died
- Lloyd's members, in relation to their underwriting business

- non-resident companies.

You must use MTD ITSA rules from 6 April 2024 if:

- you are an individual and
- registered for self assessment and
- were self-employed or collecting property income before 6 April 2023 and
- have qualifying income (see below) of more than £10,000.

HMRC anticipates checking self assessment tax returns for 2022/23 (submitted by 31 January 2024) on a case by case basis to assess whether qualifying income is such that the MTD ITSA regime will apply. It then intends to write to taxpayers confirming they are within MTD ITSA.

If you are in partnership, or become a landlord or sole trader after 6 April 2023, different dates apply:

- general partnerships (those with only individuals as partners, and not for example, corporate partners) enter MTD ITSA from 6 April 2025, if qualifying partnership income is more than £10,000
- other partnerships: HMRC has not yet specified when other partnerships join MTD ITSA
- those starting in self-employment or as landlords enter MTD ITSA after the first self assessment tax return is submitted if they meet the qualifying conditions, although they can choose to join voluntarily before this.

Qualifying income

This is a term specific to MTD ITSA. Qualifying income is the combined gross income received from self-employment and property income sources.

Qualifying income also includes:

- disguised investment management fees and income based carried interest. These are treated as the profits of a deemed trade and so constitute qualifying income
- property or trading income received as the beneficiary of a bare trust
- property or trading income paid directly to the beneficiary of an interest in possession trust, bypassing the trustees
- income from foreign property or foreign self-employment if you are resident and domiciled in the UK
- income from foreign property or foreign self-employment if you are deemed domiciled in the UK (if, however, you are remitting foreign income from a year in which the remittance basis applied, this remitted income does not make up part of the qualifying income calculation)
- if you are domiciled outside the UK, only income from UK self-employment and UK property count towards your qualifying income: not your foreign income.

It does not include:

- income from employment, dividends or savings
- income from a partnership (unless you receive disguised investment management fees or income based carried interest).

HMRC has yet to outline how MTD ITSA rules will work in some instances, and there is particular clarification needed relating to property income. We will update you as soon as further information is available. In the meantime, please do not hesitate to contact us with any concerns.

What is involved each year?

Use of appropriate software

Appropriate functional compatible software must be used for all business income and expenses. For retail sales, digital records mean a single digital record of the daily gross takings: we can advise further here.

Quarterly updates filed with HMRC

A return of income and expenditure is generated within the software and filed with HMRC. Information will be analysed into categories mirroring those within the current self assessment tax return for property and trading income. For most businesses, this will be fairly raw data, without tax and accounting adjustments.

Simplified quarterly updates

Businesses with turnover below the VAT registration limit (currently £85,000) can file simplified updates, reporting just a total for income and expenses, without analysing these by category.

Standard quarters

All businesses use the same quarters, as follows:

- 6 April to 5 July (filing deadline 5 August)
- 6 July to 5 October (filing deadline 5 November)
- 6 October to 5 January (filing deadline 5 February)
- 6 January to 5 April (filing deadline 5 May).

HMRC is working on functionality to provide the option to use calendar quarters, running 1 April to 30 June, 1 July to 30 September etc, rather than quarters ending on the fifth of the month. It is not clear when this will be available.

Estimates of tax liability

HMRC will respond to receipt of quarterly updates with estimates of tax liability, based on the figures received. In most cases, however, it will be too soon for estimates to carry significant accuracy, as underlying data will not have been adjusted for tax purposes.

Finalisation at year end

This is a two-part process, involving an end of period statement (EOPS) and a final declaration. HMRC is still fine tuning the detail, but in outline, the EOPS is a declaration allowing finalisation of business income, and is preceded by the submission of tax and accounting adjustments, such as capital allowances, prepayments and accruals. HMRC is currently calling this adjustment stage the Business Source Adjustable Summary. Taken as a whole, the EOPS process fulfils the same reporting function as the self-employment and property pages of the current self assessment tax return. If you have both trading and property income, an EOPS will be needed for each. The deadline for the EOPS is 31 January after the end of the tax year. A simplified EOPS may be filed for those below the VAT registration threshold.

The final declaration replaces the self assessment return. Designed as the last step in finalising the tax liability, it is intended to draw together all sources of income, including income sources which do not come under the MTD ITSA requirements, such as savings and dividend income. The deadline is 31 January after the end of the relevant tax year.

Details of how this process will work in practice are yet to be determined. The way that the final declaration is submitted may vary, depending on income sources, and it is not clear that all MTD software will necessarily offer this functionality. HMRC is expected to provide a facility for the final declaration to be made where this cannot be done via MTD software.

New penalty regime

New penalty rules are being introduced for late submission and late payment. They apply initially to VAT, for VAT periods beginning on or after 1 January 2023. They then roll out to MTD ITSA from 6 April 2024, and to other ITSA cases from 6 April 2025. The essence of the change is that instead of an automatic financial penalty for failure to submit on time, penalty points accrue. When a particular points threshold is reached, a penalty arises. The rules are complex and we can advise further on request.

Working with you

MTD is very much a real-time project as far as HMRC is concerned: it is expected to issue further guidance to cover gaps in the information currently available in due course. We will, of course, keep you fully up to date.

In the meanwhile, whether you have business or property interests, or both, we should be pleased to help you explore what the necessary MTD digital journey should look like, giving you confidence that you can comply with HMRC requirements and are fully prepared for the changes to come.