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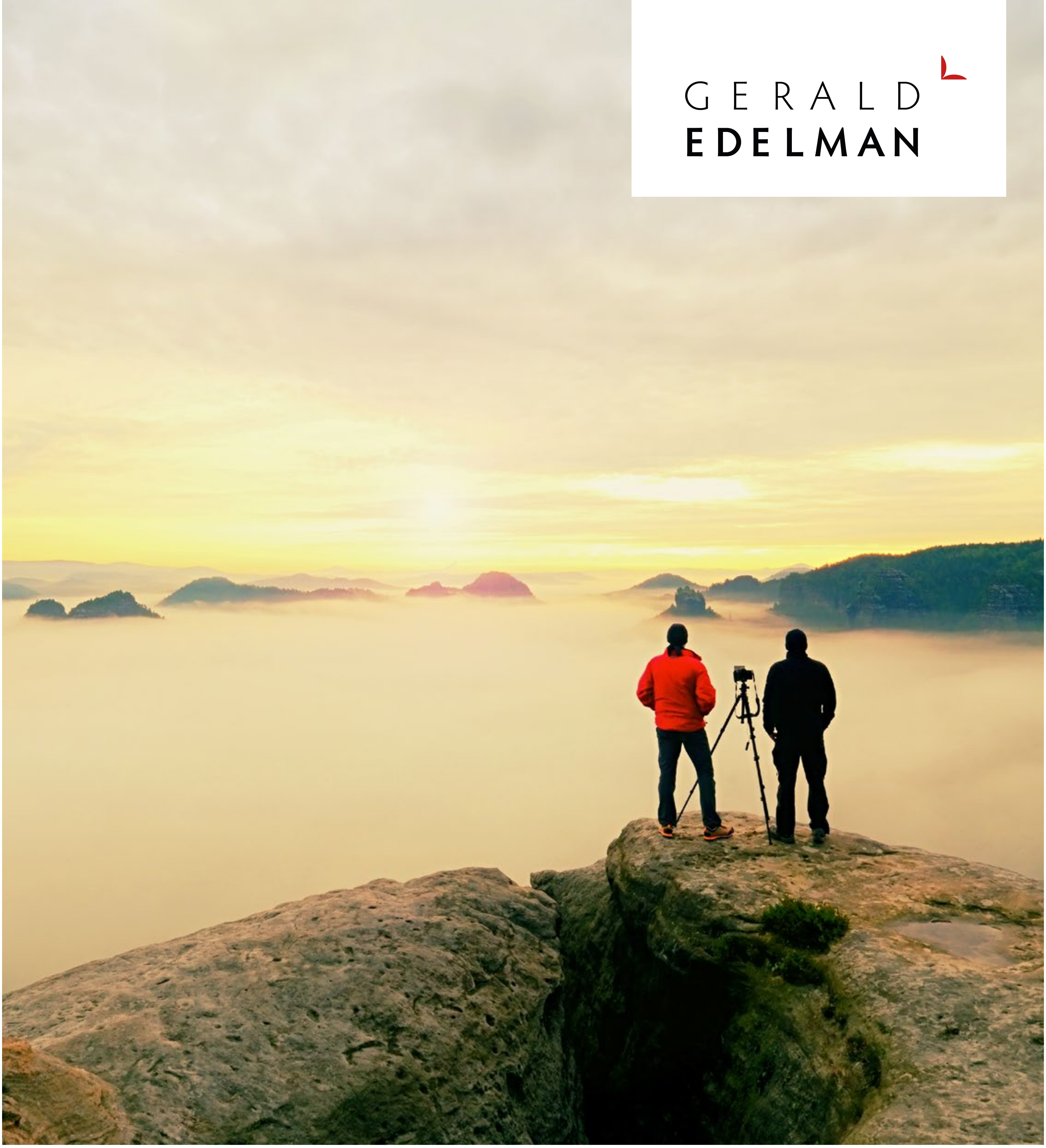


Making Tax Digital

A guide by Gerald Edelman

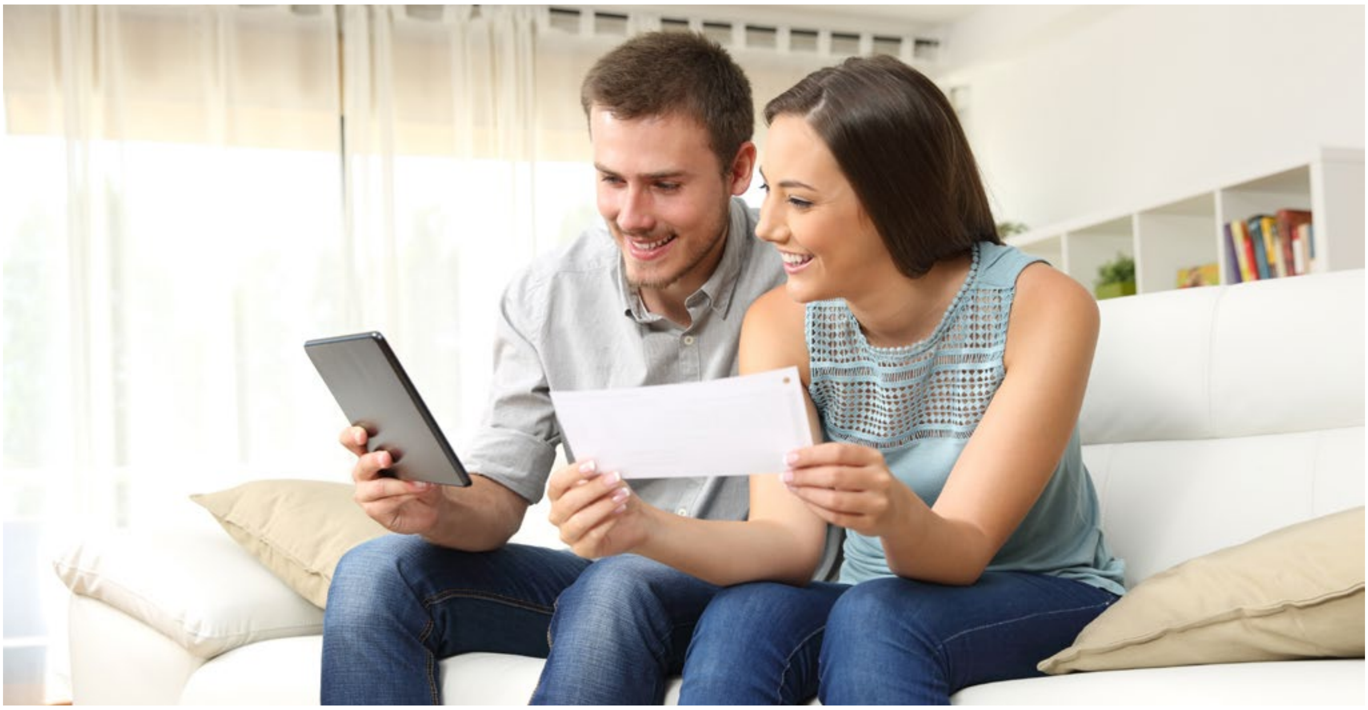
INTRODUCTION

HMRC has embarked on a plan to modernise the UK's tax administration system by 2030 to facilitate more digital reporting in 'real time', i.e. closer to the time of transactions.

MTD is being introduced tax by tax, not by business size or type.

The goal is for all regular transmissions of data between taxpayers and HMRC to be performed digitally, and where possible, automatically. HMRC is also considering how the timing of tax payments made by small companies and the self-employed can be brought closer to the time profits are made, but nothing will change until after the next General Election.

New penalty regimes for late filing of MTD reports, and for late payment of tax under MTD, have been introduced from January 2023. Daily penalties may be applied where business records are not kept in a digital medium.



The MTD timetable

Under the MTD rules nearly all businesses and landlords will be required to digitally record tax-relevant data and to use MTD-compliant software to transfer the required information directly to HMRC's systems via an application programming interface (API).

Individuals who are not in business, and who do not let property, will be encouraged (but not required) to use digital means to communicate with HMRC.

This guide concentrates on MTD for income tax self assessment (ITSA). It sets out what is known about that section of the MTD project so far.

Planning point

MTD is being introduced gradually with a separate roll-out for each tax. It will be important to keep up to date with new deadlines for reporting the taxes you pay when they are established.

The MTD project started with VAT paid by businesses from the 1 April 2019 and will be extended to ITSA reports submitted by individuals in April 2026, and then to ITSA reporting by general partnerships in 2027. MTD for corporation tax is not expected to be imposed before April 2030.

MTD ITSA

Some sole trader businesses and individual landlords will need to comply with MTD ITSA from 6 April 2026.

General partnerships with no more than 20 members, and which don't include companies as members, will need to comply with the MTD ITSA rules from a date to be announced, no earlier than 6 April 2028.

Larger partnerships, those including corporate members, and Limited Liability Partnerships (LLPs) will be required to comply with MTD ITSA regulations from a later date, which has yet to be announced.

Who will have to comply with MTD ITSA?

Unincorporated businesses and individual landlords with annual business and/or property income exceeding £50,000 will have to comply with the MTD ITSA rules from 6 April 2026. This MTD ITSA turnover threshold will be reduced to £30,000 from 6 April 2027, and it will apply across all the businesses operated by an individual.

There will be an exemption for those who are digitally excluded. The following taxpayers will also be exempt from MTD ITSA: trustees, executors or administrators of estates of deceased persons, non-resident companies who pay income tax, and the foreign business interests of non-domiciled individuals.

There may also be a deferral or exemption for: foster carers, remittance basis users, and taxpayers who cannot submit their tax return online due to their special security status or because their tax circumstances are on the list of circumstances excluded from online filing.

Example – Turnover threshold for MTD for income tax

Peter is a self-employed van driver. He lets a property for £6,000 per year and earns around £25,000 per year as a self-employed driver. As Pete's total annual business and property income is £31,000 per year, he will be over the £30,000 turnover threshold for MTD ITSA and will have to comply with the MTD ITSA rules from 6 April 2027.

> **From 6 April 2024, all unincorporated businesses will have to report their turnover, expenses, and profit or loss, to HMRC for each tax year, irrespective of the accounting period the business uses. This is referred to as the 'tax year basis'.**

Reporting business results from 2024

Currently an unincorporated business (sole-trader or partnership) reports its turnover, expenses, and profit or loss for the accounting period that ends within the tax year which the self-assessment tax return covers, and this must be received by HMRC by 31 January after the end of that tax year. This is called the 'current year' basis.

Landlords are required to report their property income for each tax year that ends on 5 April, but many report for the year to 31 March, which is treated as equivalent to 5 April.

From 6 April 2024, all unincorporated businesses will have to report their turnover, expenses, and profit or loss, to HMRC for each tax year, irrespective of the accounting period the business uses. This is referred to as the 'tax year basis'.

Where the business currently uses an accounting period that ends on 31 March or 5 April, (or a day in between those dates), it won't be affected by the switch from the current year basis to the tax year basis from 6 April 2024.

A business which draws up accounts to another date (say 30 September) will have to apportion turnover and expenses from two years of accounts to report the figures to HMRC on a tax year basis from 2024/25 to prepare for the new reporting regime under MTD ITSA.

There will be a transitional year in 2023/24 when the reporting and taxing of profits will move from the current year basis to the tax year basis. The taxpayer will be able to off-set any overlap relief against the profits assessed in 2023/24, which may have formed when the business commenced. Where excess profits are assessed in 2023/24 those extra profits will be automatically spread for tax purposes over the five years to 2027/28.

Example: Transition to tax year basis

Julie draws up her accounts to 30 September and makes a profit of £48,000 per year. In 2023/24 Julie will have to report the following profits on her self-assessment tax return:

Year to 30 September 2023

£48,000

Period: 1 October 2023 to 5 April 2024 (portion of profits from year to 30 September 2024)

£24,000

Total profits assessed, subject to overlap relief:

£72,000

The extra profits of £24,000 will be spread equally over the years 2023/24 to 2027/28 and taxed in those years.

When will MTD ITSA reports have to be submitted?

Under MTD ITSA, unincorporated businesses and landlords who are within the MTD regime will have to report to HMRC totals of their income and expenses incurred periodically, but at least quarterly. The quarters will end on: 5 July, 5 October, 5 January and 5 April, although taxpayers will be able to elect to report for calendar quarters to 31 March, 30 June, 30 September and 31 December. The quarterly report must be submitted to HMRC within one month of the end of the quarter, i.e. by 5 August, 5 November, 5 February and 5 May whether or not calendar quarters are used.

HMRC will supply the taxpayer with an estimate of the amount of tax due based on the net income reported for each quarter, but the taxpayer won't have to do anything with this information.
After the end of the tax year, the taxpayer will have to submit an End of Period Statement (EOPS), which will include any accounting adjustments, such as for capital allowances or disallowed expenses. The EOPS must be submitted by 31 January following the tax year end.

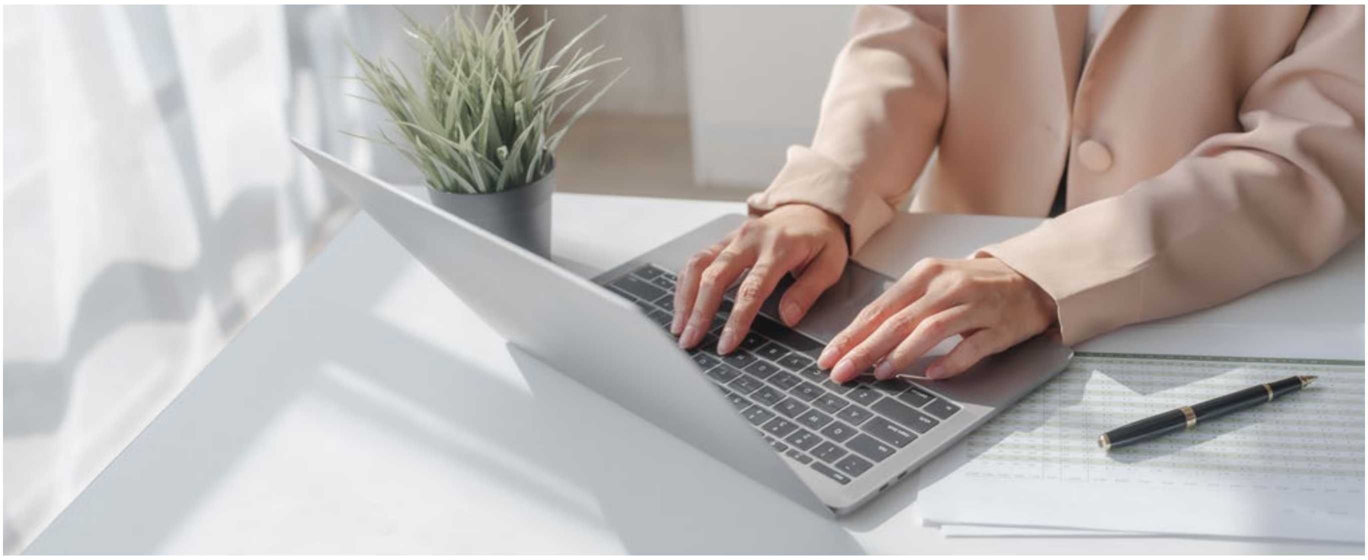
In addition, the taxpayer will finalise their tax liability in a finalisation statement, which will replace the self-assessment tax return. This will bring together all the MTD-reported sources of income, plus any other taxable income, gains and claims for the year. The finalisation statement also has to be submitted by 31 January after the tax year end, and it is envisaged that the MTD software will in most cases combine the EOPS and the finalisation statement into one submission.

In summary under MTD ITSA, you will have to submit up to five reports for each business you run each year, plus an annual finalisation statement. All of these reports need to be submitted to HMRC via MTD-compatible software.

Example: Timing of reports required under MTD ITSA

Rob is a financial consultant who makes up his accounts to 5 April each year.
Rob must start to keep digital records and file quarterly updates under MTD ITSA from 6 April 2026. He will submit his first quarterly updates, last self-assessment tax return, EOPS and finalisation statement on this timetable:

MTD Qrt/ SA return	Income and expenses in period	Deadline for submission
Y1 Qrt1	6 April 2026 – 5 July 2026	5 August 2026
Y1 Qrt2	6 July 2026 – 5 October 2026	5 November 2026
Tax return: 2025/26	Year to 5 April 2026	31 January 2027
Y1 Qrt3	6 October 2026 – 5 January 2027	5 February 2027
Y1 Qrt4	6 January 2027 – 5 April 2027	5 May 2027
Y2 Qrt1	6 April 2027 – 5 July 2027	5 August 2027
Y2 Qrt2	6 July 2027 – 5 October 2027	5 November 2027
EOPS 2026/27	Year to 5 April 2027	31 January 2028
Finalisation statement 2026/27	Year to 5 April 2027	31 January 2028



Preparing for MTD ITSA

The first step in preparing your business for MTD reporting, is to register for online your Business Tax Account (BTA) through the gov.uk website. Your BTA allows you to view all of the taxes your business pays to HMRC including PAYE and VAT. The next step is to digitise your accounting system by recording all sales and purchases digitally on a MTD ITSA-compatible software. paper-based recording system will not be acceptable.

Planning point

Your tax agent will not have access to your BTA so ensure you are registered in order to receive information from HMRC under MTD.

MTD ITSA software

HMRC has promised that free MTD ITSA software will be available for sole-trader businesses, who have no employees and who are also not VAT registered. This free software should allow those taxpayers to file reports under MTD ITSA.

HMRC expects the market to provide a range of software solutions for all sizes of business.

However, there are currently 11 software providers who have products available to use to file reports for MTD ITSA: **www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-income-tax**. There are 16 further software providers who have MTD ITSA products in development.

MTD for income tax pilot

A small pilot including a few hundred taxpayers is testing software compliance for MTD ITSA. It is open to UK residents who are sole traders with one or more businesses that have been running for two years or more. Landlords who have been letting UK property for a year or more can also join the pilot, if the property is not let as furnished holiday accommodation.

To sign up for the MTD for income tax pilot you must have MTD ITSA compatible software installed. You need to be registered for self assessment and have all your tax returns and tax payments up to date. Your accounting period also has to be exactly aligned with the tax year, ie it must end on 5 April.

You cannot currently join the MTD ITSA pilot if:

- You have income to report from any of these sources: taxable state benefits, overseas investments, or have reportable capital gains.
- You are in business as a partnership.
- You are acting as a trustee, or as a personal representative for someone who has died.
- You are in business as a Lloyd's Name or a non-resident company.

Further groups of taxpayers will be brought into the MTD for income tax pilot as new functionality is added. However, the pilot will not be extended to those who use an accounting period which does not end on 5 April, until at least April 2024.

MTD for Corporation Tax

The start date for companies to join MTD for corporation tax has not been announced, and is likely to be no earlier than April 2030, but you can start preparing for the incoming change now.

Who will have to comply?

MTD for corporation tax will apply to all entities within the charge to corporation tax, including non-resident companies, clubs and non-exempt public bodies. There will be no de-minimis turnover threshold, so even the smallest companies will have to comply.

What will the company need to do?

Companies will be required to maintain digital records of all transactions, in line with the VAT requirements. Summaries of income and expenses will be reported to HMRC quarterly using MTD-compatible software. Each total will be given an iXBRL tag automatically by the software.

> The start date for companies to join MTD for corporation tax has not been announced, and is likely to be no earlier than April 2030

The expected corporation tax liability will be reflected back to the company after each quarterly update. After the end of the accounting period, the company (or its tax agent) will make accounting adjustments to the totals supplied in the quarterly reports. The company accounts for the period will be filed with HMRC and Companies House and the tax return sent to HMRC using MTD-compatible software.

HMRC will not provide free software for submitting quarterly reports and accounts under the MTD for CT regime. The current free Company Accounts and Tax Online (CATO) software product will be discontinued in due course.

Possible simplifications

The mandation date for MTD for corporation tax is six or seven years away, and much can change in that period.

It is envisaged that filing deadlines for corporation tax and Companies House may be aligned. The treatment of profits and expenses for accounting and tax reporting may also be aligned more closely.

The MTD for corporation tax rules will be modified for large companies with annual profits exceeding £20m, who pay their corporation tax liability by way of quarterly instalments.

Complying with your general tax obligations

Whether you have to file reports under MTD sooner rather than later, it is essential that you keep complete and accurate records of your business and other income so you can make accurate tax and VAT returns.

HMRC says that MTD will help businesses keep their records up to date, reduce errors made in recording expenses, and give the taxpayer a better idea of how the business is performing. However, digital record keeping on its own will not guarantee accuracy, and you must also ensure that all relevant income and outgoings are recorded.

In the long run the MTD data will allow HMRC to target businesses for tax enquiries who are reporting expenses in unexpected categories, or unusual patterns of income. In the short term HMRC will continue to use the following methods to ensure everyone pays the correct amount of tax due:

- Undertake random or targeted compliance checks on tax returns.
- Use third party data to check the information reported in tax returns.

Where HMRC finds that a person has not taken enough care to make accurate tax returns, penalties will usually be charged. Pleading ignorance of the rules does not let you avoid penalties. Material inaccuracies are likely to be spotted, so it is worth making the effort to get your tax right.

How we can help

All businesses need to keep complete and correct accounting records to enhance business efficiency and to make accurate tax returns, whether or not they have to comply with the MTD rules.

We can review your accounting systems and advise on accounting software that will best serve your business needs.

If you need to comply with MTD for VAT or MTD ITSA, we can help you ensure your software is compatible and, where necessary, help you set up new accounting systems and become proficient at using them.

We can make the necessary reports on your behalf to HMRC, if you have authorised us to act for you, and provide direct access to your accounting data and software.

We can help you keep you up to date on any changes in tax and accounting compliance that affect your business.

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