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KEY GUIDE

Making tax digital

Introduction

DIGITISING TAX COMPLIANCE

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. This project includes the restructure of HMRC's own internal systems.

Making Tax Digital (MTD) is part of this long-term modernisation project. The ultimate goal is for all regular transmissions of data between taxpayers and HMRC to be performed digitally, and where possible automatically.

MTD is being introduced tax by tax, not by business size or type, although introduction of MTD for income tax for individuals is being staged by reference to level of income. Separate MTD reports will have to be submitted for each tax, but it may be possible for the MTD software to combine reports due around the same time into one submission process.

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

Contents

This publication is for general information and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. This publication represents our understanding of law and HM Revenue & Customs practice as at 22 April 2025.

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The Making Tax Digital timetable

Under the MTD rules nearly all businesses and landlords will be required digitally to 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 VAT and MTD for income tax self assessment (ITSA).

> **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 and will be extended to ITSA reports submitted by individuals from April 2026, and later to partnerships. MTD for corporation tax is not expected to be imposed before April 2030.

MTD for VAT has been compulsory for all VAT registered businesses (except those that are digitally excluded) since April 2022 and from earlier than that for most. The start dates for MTD for other businesses and taxes are set out in the table.

Start date	Tax
6 April 2026	MTD for income tax self-assessment (MTD ITSA): Sole-trader businesses and landlords who have annual income over £50,000 must keep digital business/property records and file quarterly updates, an annual end of period statement (EOPS), and an annual finalisation statement, all using MTD-compatible software.
6 April 2027	MTD for income tax self-assessment (MTD ITSA): Sole-trader businesses and landlords who have annual income over £30,000 will be subject to the same requirements as those with income over £50,000.
6 April 2028	MTD ITSA for sole trader businesses and landlords with annual income over £20,000.
No announced date	MTD ITSA: will be extended to partnerships.
No announced date	MTD for corporation tax: Companies will have to keep digital records and submit quarterly summaries of income and expenditure. Any adjustments required to the annual figures to bring those totals in line with Generally Accepted Accounting Practice (GAAP) will be provided in an end of statement report after the accounting period end.

The £50,000, £30,000 and £20,000 thresholds apply to the total income of individuals from self-employment and property letting.

Businesses can voluntarily sign up to the MTD ITSA pilot earlier than the required start dates. To do this, the business must have access to relevant MTD-compliant software either directly or through their accountant or tax agent.

Who may be exempt from MTD?
An individual can claim exemption from complying with the MTD rules if he or she is 'digitally excluded'. This means it is not reasonably practical (for any reason) for that person to use electronic communications or digital tools to keep digital records.

Businesses that were exempt from online filing of VAT returns before MTD are automatically treated as exempt from MTD for VAT. Those businesses can continue to use alternative arrangements to submit VAT returns to HMRC and do not have to keep digital records.

To claim exemption from MTD for VAT, the business, or their agent, should contact the VAT helpline: 0300 2003700 or write to: BT VAT HMRC BX9 1WR. The business will have to provide details about how it currently files VAT returns, the reasons why it cannot file returns through MTD-compatible software or keep digital records, and any other reason why it cannot follow the MTD rules.

Individuals who are exempt from MTD for VAT will automatically be exempt from MTD ITSA. Also exempt from MTD for ITSA will be:

- people exercising a Power of Attorney;
- non-UK resident foreign entertainers and sportspeople who have no other qualifying income for MTD;
- customers for whom HMRC cannot provide a digital service;
- trustees, executors or administrators of estates of deceased persons;
- non-resident companies that pay income tax.

Other people for whom it is not practical to use electronic communications or keep electronic records can similarly request exemption. The procedure to claim exemption from MTD ITSA filing on grounds of digital exclusion has not yet been announced but is likely to be similar to that for VAT.

There will be a one-year deferral, until April 2027, for individuals (with income over £50,000) who have to complete the supplementary tax form SA109, which covers residency status and remittance basis income under the 'temporary repatriation facility'.

A few people will have a delayed joining date (likely to be 2030 or later), namely:

- Lloyds Underwriters;
- ministers of religion;
- people who claim the married couple's allowance (where at least one partner was born before 6 April 1935) or blind person's allowance.

MTD FOR VAT
Businesses that become VAT registered are automatically included in the MTD regime upon registration, unless they are exempt or have applied for an exemption. They must keep their VAT records digitally and submit all VAT returns using MTD compatible software.

Where all the business owners are exempt from MTD for VAT the figures can be reported by telephoning HMRC, but a formal MTD exemption must be in place.

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Software requirements and providers

HMRC does not provide software to submit VAT returns under MTD but publishes a searchable list of over 500 providers of MTD-compliant software which can submit VAT returns, (see https://tinyurl.com/MTDsfwlst). At least 24 MTD software providers have free versions of their MTD VAT products available, which are mostly forms of bridging software.

Where you use spreadsheets or accounting packages to compile your VAT data, you can use MTD-compatible bridging software to read that data from the spreadsheet or accounting package and submit the required figures to HMRC via an approved API. There is no time limit on using this two-step solution to submit VAT returns as long as the different software packages or spreadsheets are connected with digital links.

EXAMPLE
Digital links

Joan is registered for VAT and has been required to use MTD since April 2019.

Joan stores her VAT receipts manually, and uses spreadsheets to maintain her VAT records. MTD does not require businesses to store original documents electronically, so Joan can continue to store her purchase receipts manually, but must record the key information concerning each purchase electronically.

Joan digitally transfers the information necessary for the VAT return into MTD-compatible software. She has chosen to use bridging software that reads the necessary figures from her spreadsheet, but there are many other forms of digital links.

Joan must still preserve her VAT records for six years, but that information doesn't have to be kept in the same digital format it is recorded in. A download of data from cloud-based accounting software meets the MTD record keeping requirements.

It is important to check what you need the MTD-compatible software to do, how it will work with your current accounting system, and whether it will provide information about the VAT you owe or your VAT payment history.

Digital record-keeping requirements

The MTD rules require VAT registered businesses to record the following data points digitally for each transaction:

- the VAT on goods and services you supplied or received;
- the time of supply for everything you sold or bought;
- the value (excluding VAT) of everything you sold or bought;
- the rate of VAT you charged on goods and services;
- your reverse charge transactions, where you record the VAT on the sale price and the purchase price of the goods and services you buy.

The law allows businesses to record totals from a supplier statement instead of individual payments in the following cases:

- When a supplier issues a statement for a period, provided all supplies on the statement are to be included on the same VAT return and the total VAT charged at each rate is shown.
- Petty cash transactions for any purchases with a VAT-inclusive value under £50, and not totalling more than (VAT-inclusive) £500.
- Supplies made or received during a charity fundraising event run by volunteers, which are covered by one invoice.
- Purchases made on your behalf, supplied by a third party, detailed in a summary document. You are not required to record these purchases until you receive information on them from the agent.

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If you use a VAT scheme (such as for retail businesses) there is some leeway for recording multiple purchases, as summarised below.

Retail schemes (used by shops, market stalls and takeaway food outlets)	Daily gross takings must be recorded. Individual sales do not need to be digitally recorded.
Flat rate scheme (for businesses with VAT taxable turnover not exceeding £150,000)	No need to digitally record purchases unless they are capital goods on which input tax can be claimed. No need to digitally record the value of goods used to determine if you need to apply the limited cost business flat rate.
Margin schemes (for items such as: antiques, second-hand cars, or works of art)	No need to keep additional records in the digital system, or the calculation of the marginal rate, although those records must be maintained in some format.

HMRC also requires the following information to be recorded digitally and submitted with the VAT return figures:

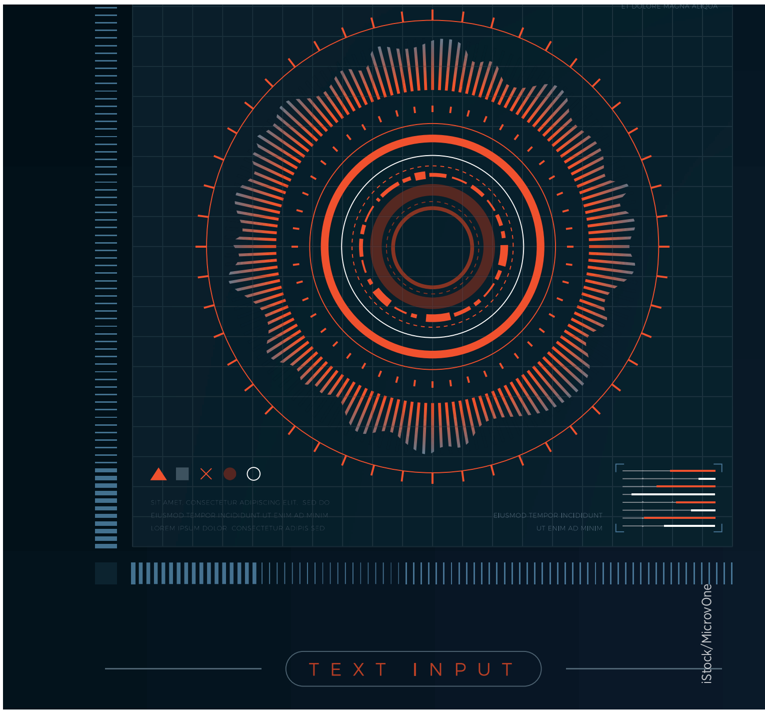
- name of the business;
- address of principal place of business;
- VAT registration number; and
- any VAT accounting schemes used, such as the flat rate scheme.

Some documents must be preserved in their original form, such as import VAT certificates (C79 forms).

Digital links
Under the MTD rules, the data necessary for the VAT return must flow from the accounting system to HMRC without human intervention to retype figures, or to copy and paste from one medium to another. The links between each piece of software should be digital rather than manual, to avoid errors from rekeying figures.

However, some calculations may have to be made outside the accounting software, such as partial exemption adjustments. It is permissible to enter data from the results of such calculations into the MTD-compatible accounting system – this action does not break the digital link.

Penalties
For VAT periods beginning on and after 1 January 2023 any returns filed late will attract a late submission point. This applies even if there is no VAT to pay as reported on the VAT return.



When a business accrues a total number of points equal to the threshold relating to their VAT return frequency, HMRC will issue a £200 penalty.

Return frequency	Points threshold	Period of compliance
Annually	2	24 months
Quarterly	4	12 months
Monthly	5	6 months

Once the points threshold has been reached any further late returns attract another £200 penalty.

Where the business completes a period of compliance during which all VAT returns are filed on time and all outstanding returns in the previous two years have been submitted, the total number of points is reduced to zero. Where the points threshold has not been reached the points levied will expire automatically after about 24 months.

The business' online VAT account will record the number of points and penalties levied.

All penalty points and monetary penalties can be appealed. Appeals are often on the basis that there was a 'reasonable excuse' for the lateness, namely a valid reason why the return could not be made on time.

Where VAT is paid late for periods beginning on and after 1 January 2023, up to two types of late payment penalties can

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be applied. The amounts charged depend on how long the payment has been overdue:

Period the payment is overdue	First penalty	Second penalty
up to 15 days	Nil	Nil
16 to 30 days	2% of VAT outstanding at day 15	Nil
31 days or more	2% of VAT outstanding at day 15 + 2% of VAT outstanding at day 30	4% per year on the outstanding balance, charged from day 31 until full debt is paid

Where the VAT is paid 31 or more days late, you will be charged the first penalty and a second late payment penalty.

If a time to pay arrangement is agreed the penalty clock stops.

HMRC may impose penalties of between £5 and £15 per day if the business fails to record VAT data digitally and/or use digital links to transfer data between different pieces of software. In addition, HMRC may charge a penalty of £100 to £400 for each VAT return that is not submitted using MTD-compatible software. The level of this penalty is determined by the annual turnover of the business.

EXAMPLE
Review of software

ABC Ltd’s bookkeeper has used an accounting software package to maintain the company’s accounting records. The company is required to submit VAT returns under MTD for VAT.

ABC Ltd’s software provider has added MTD for VAT compatibility to its accounting software package. This allows ABC Ltd’s bookkeeper to install the relevant updates to file VAT returns under MTD.

However, this is an opportunity for the company to review whether its accounting software best serves the current and future needs of the business.

MTD ITSA

The £50,000, £30,000 and £20,000 thresholds that determine when an individual must join MTD apply to the individual’s qualifying income, namely total income from self-employment and property letting.

- Where a let property is jointly owned, each owner must include their share of the income in their qualifying income.
- Individuals who are resident and domiciled in the UK, or are deemed UK domiciled, must include income from foreign self-employment or property letting.
- Income of deemed domiciled individuals remitted from a year in which they were taxed on the remittance basis does not count towards qualifying income.

- If you are resident or domiciled outside the UK, only income from UK self-employment or property is included in qualifying income.
- Qualifying care receipts of carers are not included.
- Income from a partnership does not count towards qualifying income, unless it is disguised investment management fees or income-based carried interest.

The qualifying income for any tax year is taken from the tax return that was due for submission by the previous 31 January. For example, to assess qualifying income for 2026/27, HMRC will look at the tax return for 2024/25, due by 31 January 2026. If the 2024/25 tax return shows qualifying income of more than £50,000, you will have to use MTD from 6 April 2026. HMRC will tell taxpayers whose 2024/25 tax returns show qualifying income of more than £50,000, but the obligation to use MTD does not depend on receiving notification from HMRC.

Individuals whose business accounts run to 31 March can start their MTD obligations on 1 April instead of 6 April in the first year of operating MTD. This will avoid year-end adjustments.

EXAMPLE
Turnover threshold for MTD for income tax

Pete 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.

If your accounting period is longer or shorter than 12 months you should annualise your income. For example if you become a sole trader but have only been trading for six months in 2024/25, you should double your income to find your qualifying income.

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 for each source of income 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 will not 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.

Taxpayers within MTD will no longer be able to submit their tax return in HMRC's separate online filing system. Instead their EOPS will include all other income, such as dividends and interest, chargeable gains and claims for the year.

In summary, under MTD ITSA, you will have to submit up to five reports for each business you run each year, plus an end of year 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

What must be included in quarterly reporting
Each quarterly update must show the start and end dates of the period.

A self-employed person must also report:

- business turnover
- other business income
- cost of goods
- other business expenses under a series of specified headings.

A person with property income must report:

- total rent
- other property income
- lease premiums and reverse premiums
- property expenses under a series of specified headings.

If your turnover from either self-employment or property letting is below the VAT registration threshold, you can use three-line accounting. This allows digital records to be tagged simply as income or expense. The one exception is where a landlord has finance costs such as mortgage interest, which must always be tagged separately.

Joint property owners
If you let property jointly you only record and report your own share of income and expenses. There are some ways in which you can simplify your recording and reporting:

- You can adopt three-line accounting;
- Instead of keeping full digital records, you can record a single total amount for property income received during a quarter, and for property expenses incurred during the tax year;

- Your quarterly reports then need only show a single figure for income with a single figure for your share of the expenses entered at the end of the tax year.

Preparing for MTD ITSA

The first step in preparing your business for MTD reporting is to activate your Business Tax Account (BTA). 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. You may choose to use accounting software or spreadsheets (with digital links to MTD-compliant software) for this task. A paper-based recording system will not be acceptable.

You can start to keep digital records at any point and HMRC recommends doing this ahead of your MTD ITSA start date to allow you to get used to it.

MTD ITSA software

You will have to use commercial software that works with MTD ITSA if you wish to join the MTD ITSA pilot (see below) and in any case from the date you are required to use MTD reporting. HMRC does not provide its own software but there is some free software for the smallest and uncomplicated businesses that will 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. HMRC currently lists 20 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. Several software providers have further MTD ITSA products in development.

MTD for income tax pilot

HMRC is running a limited pilot of quarterly reporting to test software compliance for MTD ITSA. It is open to UK residents who are sole traders with one or more businesses who have submitted at least one self-assessment tax return. Landlords who have been letting UK property for a year or more can also join the pilot

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 aligned with the tax year, i.e. it must end on 5 April, although an accounting date of 31 March is also acceptable if the software you choose supports this.

You cannot currently join the MTD ITSA pilot if:

- You have a high income child benefit charge or a payment plan with HMRC, or are subject to a compliance enquiry.
- You are a partner in a partnership.

- You claim married couple's allowance or blind person's allowance.
- You are an MP, minister of religion or Lloyd's underwriter.
- You have income from: being a foster carer, a trust, a jointly owned property or a furnished holiday let.
- You use averaging, for example as a farmer, writer or artist.

Taxpayers in the pilot will not be able to claim carry back of losses, or change their accounting period or accounting method.

From April 2025 most sole traders and landlords will be eligible to join the pilot.

Penalties

If you sign up to the MTD pilot you will be subject to the new late submission and late payment penalties instead of the existing penalties. Taxpayers have to confirm that they want the new penalties to apply to them as part of the signing up process. The new penalties will apply to all taxpayers once they are required to use MTD ITSA.

The new late submission penalties are points-based, like the equivalent VAT penalties. This means you will not face financial penalties for a single mistake but only if you persistently fail to meet your obligations. The late payment penalties are more proportionate to the amount of tax owed and the time it takes to pay it. They will arise as follows:

- Each late annual return will attract a penalty point until the penalty point threshold of two points is reached.

- A £200 penalty will be charged when the two-point threshold is reached.
- Another £200 penalty will be charged if you miss the deadline for submitting any more annual returns.
- If you have not reached the penalty point threshold, the individual penalty point will be removed automatically about 24 months after it is incurred.
- If you have reached the penalty point threshold the points will be removed after a 24-hour period of submitting all your obligations on time.
- No late submission penalty points will be charged for missing quarterly updates during the testing period.
- After the testing period, each late quarterly return will attract one penalty point and a £200 penalty will be charged after four points.

Late payment penalties will be charged where any payment, other than a payment on account, is more than 15 days overdue. Late payment interest is also charged from the first day after the payment due date. The penalty calculation is the same as for VAT late payments (see above).

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 the ground now.

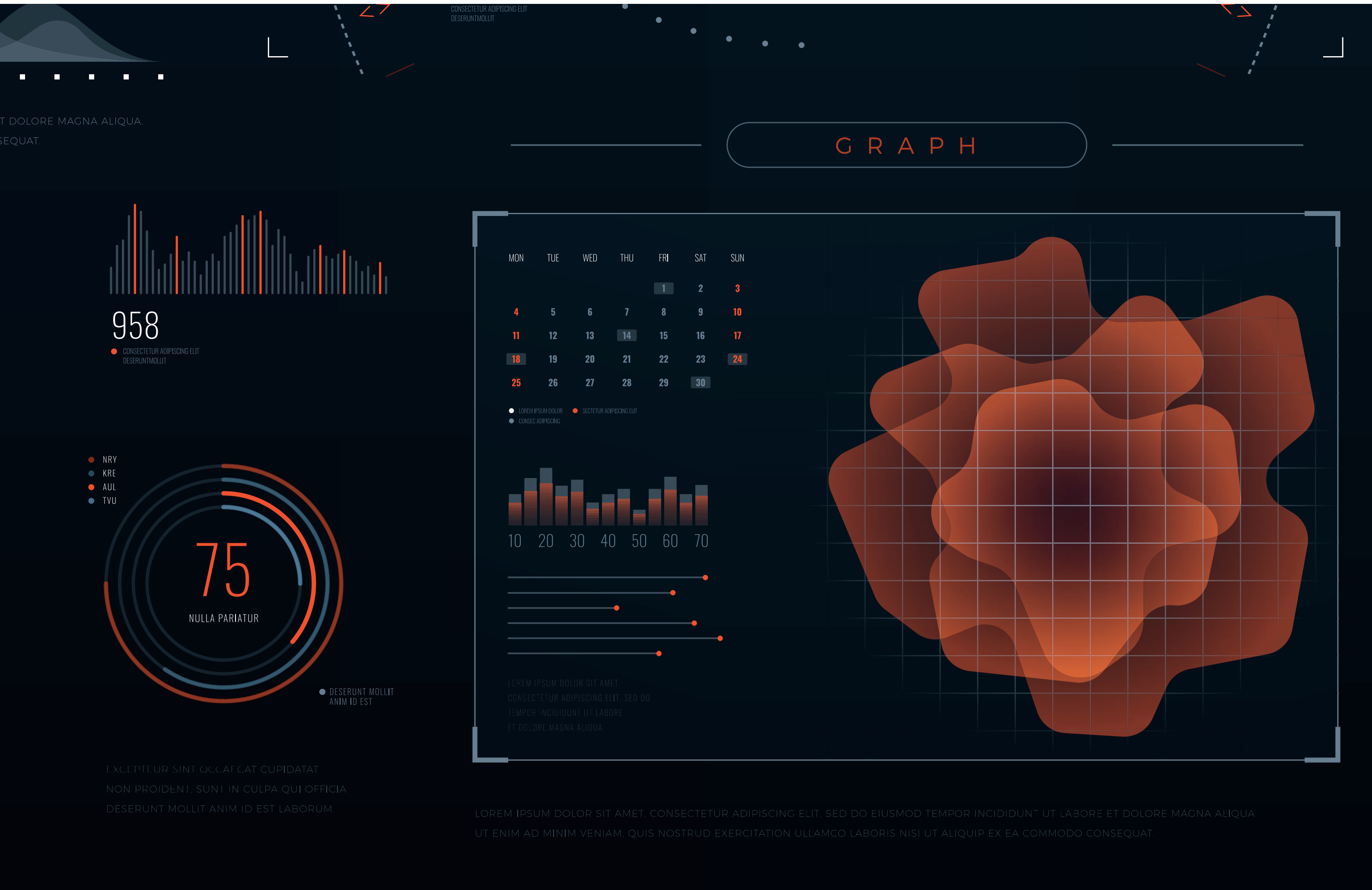
Who will have to comply?
MTD for corporation tax will apply to all entities within the charge to corporation tax, including non-resident companies, clubs and non-exempt public bodies. There will be no de-minimis turnover threshold, so even the smallest companies will have to comply.

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 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 four or five years away, and much can change in that period.

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, which 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 that are reporting expenses in unexpected categories, or have 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 avoid penalties. Material inaccuracies are likely to be spotted, so it is worth making the effort to get your tax right.

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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 with IT security and keep you up to date on any changes in tax and accounting compliance that affect your business.

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