

HM

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KEY GUIDE

Making tax digital

Introduction

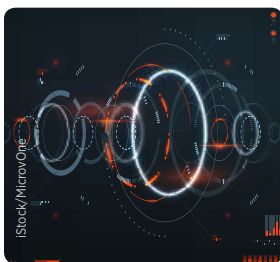
DIGITISING TAX COMPLIANCE

HMRC is formulating a ten-year plan to modernise the whole of the UK's tax administration system by 2030 which will facilitate more digital reporting in 'real time', i.e. closer to the time of transactions. To achieve this HMRC will have to restructure its own internal systems and parliament will need to rewrite large parts of the tax law. For example, HMRC has proposed a new structure for penalties which are imposed for late filing and is looking into changing the timing of tax payments made by small companies and the self-employed.

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 for business is being introduced tax by tax, not by business size or type. Although separate reports will have to be submitted for each tax in the short term, the submission process could be streamlined in the future once tax law is aligned for all business taxes.

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The Making Tax Digital timetable

Under the MTD rules most businesses 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 business and 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, as and when they are established.

The MTD project has started with VAT paid by businesses and will be extended to income tax paid by individuals in 2023, and then to corporation tax no earlier than April 2026.

MTD for VAT became compulsory for VAT periods starting from April 2019, but a small number of complex organisations had their MTD start date deferred to the first periods starting from October 2019, or in some cases later.

Start date	Tax
VAT periods beginning on and after 1 April 2019	MTD for VAT: Businesses that are registered for VAT with annual VATable sales above £85,000 must keep digital records and file VAT returns using MTD-compatible software
VAT periods beginning on and after 1 October 2019	MTD for VAT: Organisations that are registered for VAT and who have been given a deferred start date for MTD by HMRC must keep digital records and file VAT returns using MTD-compatible software.
VAT periods beginning on and after 1 April 2022	MTD for VAT: All VAT registered businesses must keep digital records and file VAT returns using MTD-compatible software..
Accounting periods beginning on and after 6 April 2023	MTD for income tax self-assessment (MTD ITSA): Unincorporated businesses and landlords who have annual turnover exceeding £10,000 must keep digital records relating to their business or property income and make quarterly reports using MTD-compatible software.

Accounting periods starting no earlier than April 2026

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 another report after the accounting period end.

Certain public sector bodies including NHS trusts and government departments which use the GIANT system of VAT reporting have had their start date for MTD for VAT pushed back to April 2022.

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

MTD FOR VAT

MTD for VAT became compulsory for most VAT registered businesses from the start of their first VAT period which commenced on or after 1 April 2019.

Who must comply with MTD for VAT

VAT registered businesses with 'VATable' turnover above the VAT registration threshold (frozen at £85,000 until 31 March 2024) for the last 12 months need to comply with the MTD for VAT rules. VAT registered businesses with turnover under the VAT registration threshold are automatically exempt from MTD for VAT until April 2022, but they can voluntarily join the MTD regime in advance.

VATable turnover includes all sales which carry VAT at the standard (20%), reduced rates (12.5% or 5%) or zero rate. Sales of goods or services which are outside the scope of VAT or are exempt from VAT are not counted within this turnover test.

The business must measure its taxable turnover on a rolling 12-month basis to the end of each month, starting with the year to 31 March 2019. When turnover during that period exceeds the VAT registration threshold, the business must

comply with the MTD rules from the start of its next VAT period. If the turnover drops below the VAT registration threshold the business must still comply with the MTD for VAT rules until it cancels its VAT registration.

Businesses which become VAT registered because their VATable turnover has exceeded the VAT registration threshold, must enter the MTD regime immediately with their first VAT return.

A business can claim exemption from the MTD rules if it is not reasonably practical for all the business owners to keep digital records or to use software to submit the VAT return – for example because of disability, age, or being based in a remote location with no internet access. Exemption may also be claimed on religious grounds.

Businesses which are exempt from online filing for VAT due to age, disability or lack of internet connection are automatically treated as being exempt from MTD for VAT. Those business can continue to use alternative arrangements to submit VAT returns to HMRC.

To claim exemption from MTD for VAT, the business, or their agent, should contact the VAT helpline: 0300 2003700 or write to: HMRC, VAT Written Enquiries Team, 123 St Vincent Street, Glasgow G2 5EA. The business will have to provide details about how it currently files VAT returns, the reasons why it cannot file returns through software or keep digital records, and any other reason why it cannot follow the MTD rules.

How MTD will affect your VAT returns

Under MTD, businesses must record and retain their VAT records in a digital format and submit VAT returns using MTD-compatible software.

The information submitted to HMRC is exactly the same data as submitted on the VAT return form. Only the method of delivering the VAT return has changed; the underlying VAT calculations (which are not sent to HMRC), and the timing of VAT payments remain the same.

Submitting a VAT return under MTD

Under MTD for VAT, businesses must use MTD-compliant software to submit their VAT returns, unless they are currently exempt from MTD.



If you don't use accounting software to submit your VAT returns you need to identify what commercial software solutions will suit your business. This may involve a number of software packages or spreadsheets which transfer data between them by way of digital links (see below). HMRC will not provide free software to submit VAT returns under MTD.

PREPARING FOR MTD FOR VAT

There are various specific requirements for recording and transmission of data under MTD for VAT, so it is important to make sure you review business systems before the soft-landing period for digital links expires with the first period that starts on or after 1 April 2021.

Planning point

You need to sign up for MTD for VAT with HMRC at least 72 hours before your first VAT return is due under MTD. Your accountant can also do this for you. If you pay VAT by direct debit you should sign up for MTD at least seven days before your next VAT return is due.

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.

Software requirements and providers

There are over 500 providers of MTD-compliant software which can submit VAT returns, (see www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-vat).

MTD-compatible bridging software can be used with existing spreadsheets or accounting packages to submit the required data to HMRC via an approved API. There is no time-limit on using this two-step solution as long as the different software packages are connected with digital links.

If your business is required to be within the MTD for VAT regime, but you are not currently using accounting software,

you need to consider enhancing your record keeping with digitally linked accounting systems.

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 is able to continue to store her purchase receipts manually, but records the key information concerning each purchase digitally.

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.

Register for MTD

Businesses have to sign up for MTD for VAT with HMRC before their first VAT return is due under MTD. This is a necessary step even if the business is already VAT registered and HMRC has all the business' contact details.

The sign up for MTD can be done only once the MTD-compatible software is in place, and it must be completed at least one week before the first VAT return is due under MTD. The sign-up process is done through your Business Tax Account (BTA). The BTA is an online account where a business can view a summary of all its tax liabilities and repayments. It is accessed through the Government Gateway and requires a two-step ID verification process.



Digital record-keeping requirements

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

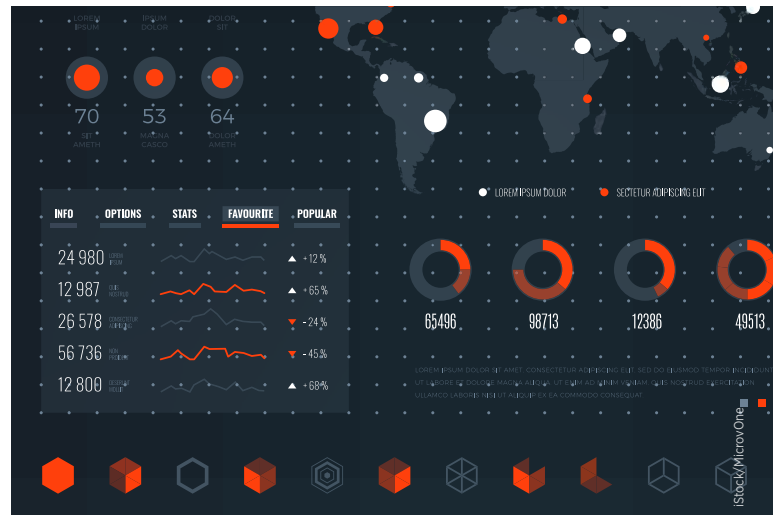
Sales	Purchases
Time of sale (tax point)	Time of purchase (tax point)
Value excluding VAT	Value net of VAT
Rate of VAT charged	Amount of VAT to reclaim

HMRC has acknowledged there are benefits to both recording each individual invoice, and recording totals from a supplier statement in the digital accounting system. The law allows businesses to record the totals 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.

The different VAT schemes also retain some leeway when it comes to recording multiple purchases. These are summarised in the following table.

Retail schemes (for example shops or 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 of no more than £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 rate.



Gold special accounting scheme (applies to standard rated supplies of gold)

You must digitally record the value of sales made and total output tax on purchases.

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 keying errors.

However, some calculations may have to be made outside of 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.



Many businesses use a combination of accounting packages and spreadsheets to calculate the totals needed for the VAT return, and it will take some time to convert all accounting systems to include digital links. HMRC has allowed a soft-landing period to give businesses time to create a purely digital journey for the VAT data from creation to submission to HMRC. This soft-landing period ends with the start of the first VAT period for the business that begins on or after 1 April 2021, unless an extension to that period is requested.

Businesses are expected to make every effort to digitise their VAT recording systems within this soft-landing period, but where another business has been acquired, or the IT system is particularly complex or old, it can ask HMRC for a specific direction to extend the soft-landing period for a defined period.

Penalties may be imposed where the business makes no attempt to comply with its MTD obligations to record, transmit and store VAT data digitally.

Secure your systems

If you move to an online accounting package, it is essential that your data is secure (the same applies to any use of a device connected to the internet). IT systems are vulnerable to many kinds of attack, for example malware, viruses, worms, hacking, phishing, access by unauthorised persons, theft of data and theft of hardware. Software and hardware can also malfunction or suffer other accidental damage.

However, you should not let the risks put you off. There are several basic precautions you should take:

- Run regular and frequent backups of data.
- If data is stored in the cloud, access to it must be protected and the data must be backed up.
- Use strong, memorable passwords and change them regularly. Other forms of secure access are available, from storage software to fingerprint recognition.
- Only give your employees and agents access to those systems and data that they need to carry out their jobs.

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 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.

- Keep anti-virus and other protective software up to date (some operating systems do this automatically).
- Ensure that you and anyone else who uses your computers in your business exercise great care when opening emails, especially those containing links or attachments.
- Keep your premises secure.

You may already do many of these things to protect your business, especially if you bank, pay bills and interact with suppliers and customers online.

Planning point

You should review online security on a regular basis. Even if your system was state of the art a couple of years ago, it may not pass muster now.

MTD ITSA

Unincorporated businesses and landlords will need to join MTD for income tax self-assessment (ITSA) from the first accounting period that starts on or after 6 April 2023, but you can start working towards compliance now.

Who will have to comply?

All unincorporated businesses and individual landlords with annual business or property income exceeding £10,000 will have to comply with the MTD ITSA rules. The MTD turnover threshold will apply across all businesses operated by an individual.

There is an exemption for partnerships with turnover of £10 million. The entry date to the MTD regime for Limited Liability Partnerships (LLPs) and for partnerships which include individuals and companies has not been announced.

EXAMPLE

Turnover threshold for MTD for income tax

Pete is a retired teacher with a pension of £20,000. He lets a property for £6,000 per year and earns around £5,000 per year as a self-employed gardener. He draws up accounts for both these businesses on a tax year basis.

As Pete's annual business income is £11,000 per year, he will be over the £10,000 income threshold for MTD ITSA and will have to comply with the MTD rules from 6 April 2023.

How MTD will affect your income tax for business returns

Currently an unincorporated business (sole-trader or partnership) reports its turnover, expenses, and profit or loss to HMRC once a year on the self-assessment tax return. This return must be submitted by 31 January following the end of the tax year in which the business accounting period ends. Landlords report rental income for each income tax year which ends on 5 April.

Under MTD ITSA for income tax, the business will have to report totals of income and expenses each quarter to HMRC, within one month of the quarter end. This report will have to be submitted using MTD-compatible software. HMRC will supply the business with an estimated amount of tax based on the net income reported for that quarter, which will allow the business owner to estimate their tax bill.

At the end of the accounting year, income and expenses are reported for the fourth quarter. The taxpayer will also have to make any accounting adjustments, such as for capital allowances or disallowed expenses in an end of period statement if those adjustments haven't already been made in the fourth quarter report.

In all cases the taxpayer will have to finalise their tax liability in a process which will replace the self-assessment tax return. This will bring together all the MTD-reported sources of income, plus any other taxable income or gains and claims for the year.

This means, under MTD ITSA, one self-assessment tax return will turn into four, five or six reports per year to HMRC.

Preparing for MTD ITSA for business

The first step in preparing your business for MTD reporting, as with VAT, is to activate your BTA which 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. You may choose to use accounting software or spreadsheets for this task. A paper-based recording system will not be acceptable.



Planning point

If you have to sign up for MTD you will need to register for a Business Tax Account (BTA) in order to receive information from HMRC under MTD. Your tax agent will not have access to your BTA.

Accounting 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 will allow those individuals to file reports under MTD for ITSA, but not for VAT.

HMRC expects the market to provide a range of software solutions for all sizes of business. However, there are currently only seven software providers who have products available to use to file reports for MTD for income tax: <https://www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-income-tax>. There are five more products in development.

MTD for income tax pilot

A pilot scheme is underway to test software compliance for MTD ITSA. It is open to UK residents who are sole traders with just one business, and landlords who only let out UK property in their sole name which is not furnished holiday lettings.

To sign up for the MTD for income tax pilot you must be registered for self assessment and have all your tax returns and tax payments up to date. You cannot currently join the MTD for income tax pilot if:

- You have income to report from sources other than sole trader business or UK property.
- You are in business as a partnership.
- You have received a grant under any of the following:

- the coronavirus self employed income support scheme (SEISS);
 - the coronavirus job retention scheme (CJRS);
 - the eat-out to help out scheme for businesses in the hospitality sector.
- You have income from other non-business sources.
 - You must report payments that qualify for additional tax relief such as pension contributions.

Further groups of taxpayers will be brought into the MTD for income tax pilot as new functionality is added.

MTD FOR CORPORATION TAX

The deadline for companies to join MTD for corporation tax will be no earlier than April 2026, 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 over five 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 or not you will have to use MTD, 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.

MTD on its own will not guarantee accuracy. You still must make sure that all relevant income and outgoings are recorded. However, HMRC says that MTD will help businesses to get their tax declarations right first time.

MTD is not HMRC's only strategy for ensuring everyone pays the correct amount of tax due:

- HMRC makes compliance checks on tax returns, which may be random, or triggered by the figures in the return.
- An increasing amount of information comes from third parties, which HMRC uses to check information 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 good 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, 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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