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Making Tax Digital: what we know so far

The government's new digital tax initiative is due to be phased in between 2018 and 2020, with the stated aim of creating an 'accessible tax system fit for the digital age'. HMRC has been consulting on the detail and, following feedback from the business community, has now published its response regarding the much-debated new framework. This factsheet considers the new rules in more detail.

Making Tax Digital: an overview

Making Tax Digital (MTD) is a new government initiative that aims to modernise the tax system for individuals and businesses. The new regime will see taxpayers move to a fully digital tax system, with businesses and individuals required to register, file, pay and update their information using a secure online tax account.

MTD for individuals: the Personal Tax Account

Digital tax accounts for individuals – Personal Tax Accounts (PTAs) – have already been created by HMRC. The accounts are pre-populated with information already held by HMRC. PTAs are set to be developed further and in 2018 taxpayers will be able to report any additional sources of income through their digital account.

Individuals may wish to register for a personal tax account by visiting **www.gov.uk/personal-tax-account**. HMRC anticipates that, over time, many individuals with straightforward tax affairs may no longer need to complete a tax return.

MTD for Businesses (MTDfB): how will it work?

A large part of the MTD initiative is aimed at businesses. By 2020, most businesses, self-employed people and landlords will be required to use software or apps to keep digital business records and make regular updates to HMRC in respect of their income tax, VAT and national insurance contributions (NICs) online. Updates will need to be made at least quarterly. When an update is due, taxpayers will have a period of one month to compile and submit their financial records.

As the year progresses, businesses will have supplied HMRC with regular updates regarding income and expenditure. They can then review the information they have previously provided, to make any necessary accounting adjustments or claim any reliefs or allowances. Once final adjustments have been made, they will be required to make an 'End of Year' declaration, in which they will need to state that everything is accurate and complete. These changes will be phased in from 2018, with the start date depending on a business's accounting period. HMRC has begun piloting digital record-keeping and quarterly updates from April 2017, and will do so for a full year.

In the 2017 Spring Budget the government announced a one year deferral from the mandating of MTD for unincorporated businesses and landlords with turnovers below the VAT registration threshold. They will now be required to start using the new digital service from April 2019. The government will also consult on the design aspects of the tax administration system, including interest and penalties, with the aim of adopting a consistent approach across taxes.

MTD consultations: a closer look

In August 2016, HMRC published a collection of MTD consultations. The government issued its response to these consultations on 31 January 2017 and some of the key points are summarised below.

1. Bringing business tax into the digital age

The first consultation considered the practicalities of switching to compulsory digital record-keeping and providing quarterly updates. This included whether any practical help, financial support or extra tax relief might be required.

The government has decided:

- businesses will be able to use spreadsheets for record-keeping, but they must ensure that these meet the relevant MTDfB requirements
- the requirement to keep records digitally does not mean firms have to make and store receipts and invoices online
- charities (but not their trading subsidiaries) will not be required to keep digital records
- for partnerships with turnover exceeding £10 million, MTDfB will be deferred until 2020
- end of year activity must be concluded and sent to HMRC by either 31 January or ten months after the last day of the period of account (whichever is sooner).

2. Simplifying tax for unincorporated businesses

This consultation sought input on changing the way the self-employed map accounting periods onto the tax year ('basis period' reform). It also outlined proposals to simplify the cash basis and to extend this to larger businesses. The cash basis means a business accounts for income when actually received, less cash payments of allowable expenses. However, no relief is given until an expense is paid for in cash. If a business has a large item of expenditure (for example, plant purchased just before the year end), the relief will be deferred until the next year.

Currently, the rules for the calculation of profits under cash basis accounting do not allow a deduction for expenditure of a capital nature, unless that expenditure qualifies for plant and machinery capital allowances under ordinary tax rules. This results in taxpayers needing to consider whether items are capital in nature, and whether they qualify for capital allowances.

The government has decided:

- the entry threshold for the cash basis will increase to £150,000 for the 2017/18 tax year. The exit threshold will be set at double the new entry threshold, so this will increase to £300,000
- the rules on capital and revenue expenditure within the cash basis will be simplified to help businesses calculate whether expenditure is deductible.

No conclusion has been reached on the reform of basis periods.

3. Simplified cash basis for unincorporated property businesses

The third consultation proposed to extend cash basis accounting to unincorporated property businesses, including non-resident landlords and those with furnished holiday lettings. Tax relief on interest costs will continue to be restricted to the basic rate of income tax for those with residential properties.

The government has decided:

- cash basis accounting will be extended to unincorporated property businesses where the cash basis receipts do not exceed £150,000
- the cash basis will be the default basis but a landlord can opt for the accruals basis (the basis currently used)
- the new basis will apply for the 2017/18 tax year.

4. Voluntary pay as you go

This consultation outlined plans to allow businesses to make voluntary tax payments on a 'pay as you go' basis, considered how payments will be distributed across an individual's taxes, and explored methods of handling voluntary repayments.

The government has decided:

- to make voluntary payments easily repayable, HMRC will only refrain from making a repayment where a liability is about to become due and where the client failed to pay on time in the past 12 months. HMRC will leave early repayments until MTD is 'fully embedded'.

5. Tax administration

This consultation considered how the tax administration framework could be adapted for MTD, including in relation to penalties.

The government has decided:

- legislation concerning HMRC's compliance powers is included in Finance Bill 2017. A further consultation document will consider the appropriate penalty regime for the late submission of information. However, taxpayers will be granted at least 12 months before they are charged any late submission penalties under MTD.

6. Transforming the tax system through the better use of information

This focused on how HMRC could make better use of the information provided by third parties. Last year, HMRC began to make use of previous tax year bank and building society interest information in order to amend all taxpayers' PAYE codes, where the bank or building society account is held by one individual.

From 2017, the government intends to begin using current PAYE information during the tax year in order to calculate whether the correct amount of tax is being paid. From 2018, banks and building societies will need to provide details of interest on a more frequent basis during the tax year.

The government has decided:

- the third party information provider should notify the taxpayer at the time it submits information to HMRC for use in the digital tax account. There will need to be more than one method for doing this. The government will also work with information providers to co-design a process for resolving taxpayer queries where a client believes the data supplied is incorrect
- to adopt a more gradual approach to using additional sources of third party information.

How we can help

The government is consulting on the specific details and final legislation is due to be published later this year. Currently, you are not required to take any action in respect of the new rules. As always, we will continue to assist you with your tax affairs, although please note that we cannot currently access the PTA on your behalf. We will be keeping up-to-date with the latest developments in relation to the MTD regime.

To discuss how the MTD reforms may affect you, please contact us.