CARBON ACCOUNTANCY
CHARTERED ACCOUNTANTS

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. 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, have been introduced from January 2023. Daily penalties may be applied where business records are not kept in a digital medium.

HMRC is 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.

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 12 January 2023.

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The Making Tax Digital 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 VAT and 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 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 for VAT became compulsory for most VAT registered businesses for VAT periods starting from April 2019. The start dates for MTD for other businesses and taxes are set out in the table.

Start date	Tax
VAT periods beginning on and after 1 April 2019	MTD for VAT: VAT registered businesses 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: VAT registered organisations who were given a deferred start date for MTD 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 and organisations must keep digital records and file VAT returns using MTD-compatible software.
6 April 2026	MTD for income tax self-assessment (MTD ITSA): Sole-trader businesses and landlords who have annual turnover exceeding £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 turnover exceeding £30,000 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.
Accounting periods starting no earlier than 6 April 2028 (not confirmed)	MTD ITSA: General partnerships (not LLPs) with no more than 20 members and don't include companies as members, which have annual turnover over £30,000, must keep digital business records and file quarterly updates, an annual end of period statement (EOPS), and an annual finalisation statement, all using MTD-compatible software.
Accounting periods starting no earlier than April 2030 (not confirmed)	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.

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. For a partnership to be exempt from MTD all of the partners must be digitally excluded.

Businesses which were exempt from online filing of VAT returns before MTD are automatically treated as being exempt from MTD for VAT. Those businesses 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: 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.

The procedure to claim exemption from MTD ITSA filing has not been announced.

MTD FOR VAT

MTD for VAT became compulsory for all remaining VAT registered businesses from the start of their first VAT period which commenced on or after 1 April 2022.

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

How does MTD 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 old 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
Businesses must use MTD-compliant software to submit their VAT returns. The alternative route of posting the VAT figures on an interactive form on the gov.uk website has been closed.

Where all of 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.

HMRC does not provide software to submit VAT returns under MTD.

Software requirements and providers
There is 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.

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.

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.

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

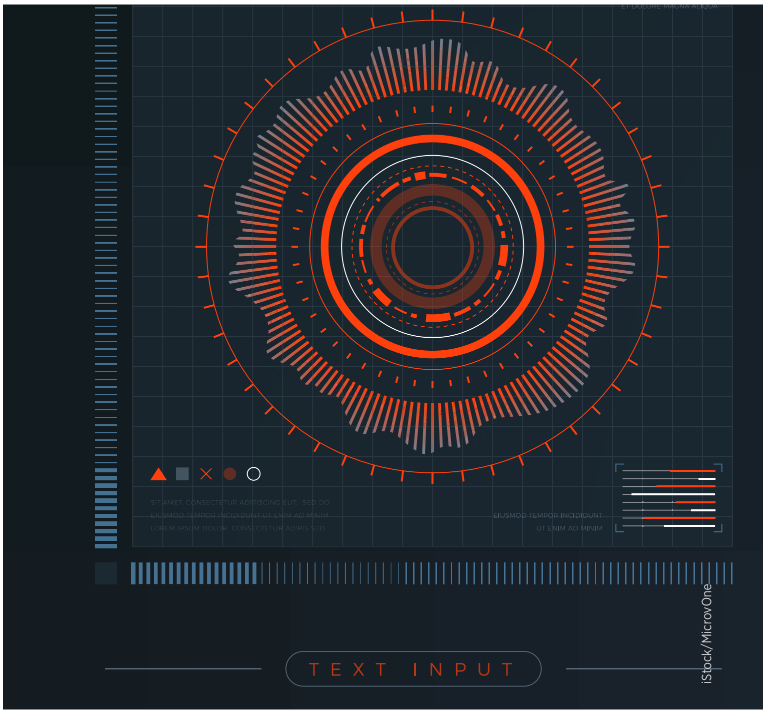
Sales	Purchases
Time of sale (tax point)	Time of purchase (tax point)
Value excluding VAT	Value net of VAT
Rate of VAT charged	Amount of VAT to reclaim

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.

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 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.

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Penalties

For VAT periods beginning on and after 1 January 2023 any late filed returns 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.

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

For payments due in 2023, if the business is doing its best to comply, HMRC will only apply late payment penalties where the VAT is paid over 30 days late. VAT returns and payments for periods beginning before 2023 are not drawn into the new penalty regimes for late filing or late payment.

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 which is not submitted using MTD-compatible software. The level of this penalty is determined by the annual turnover of the business.

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.

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.

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

There will be an exemption for those who are digitally excluded (see above). 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

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.

Planning point

In order to sign up for MTD ITSA you first need to have installed MTD ITSA-compatible software. You also need to register for your online Business Tax Account (BTA) through the gov.uk website in order to receive information from HMRC under MTD. Your tax agent will not have access to your BTA.

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.

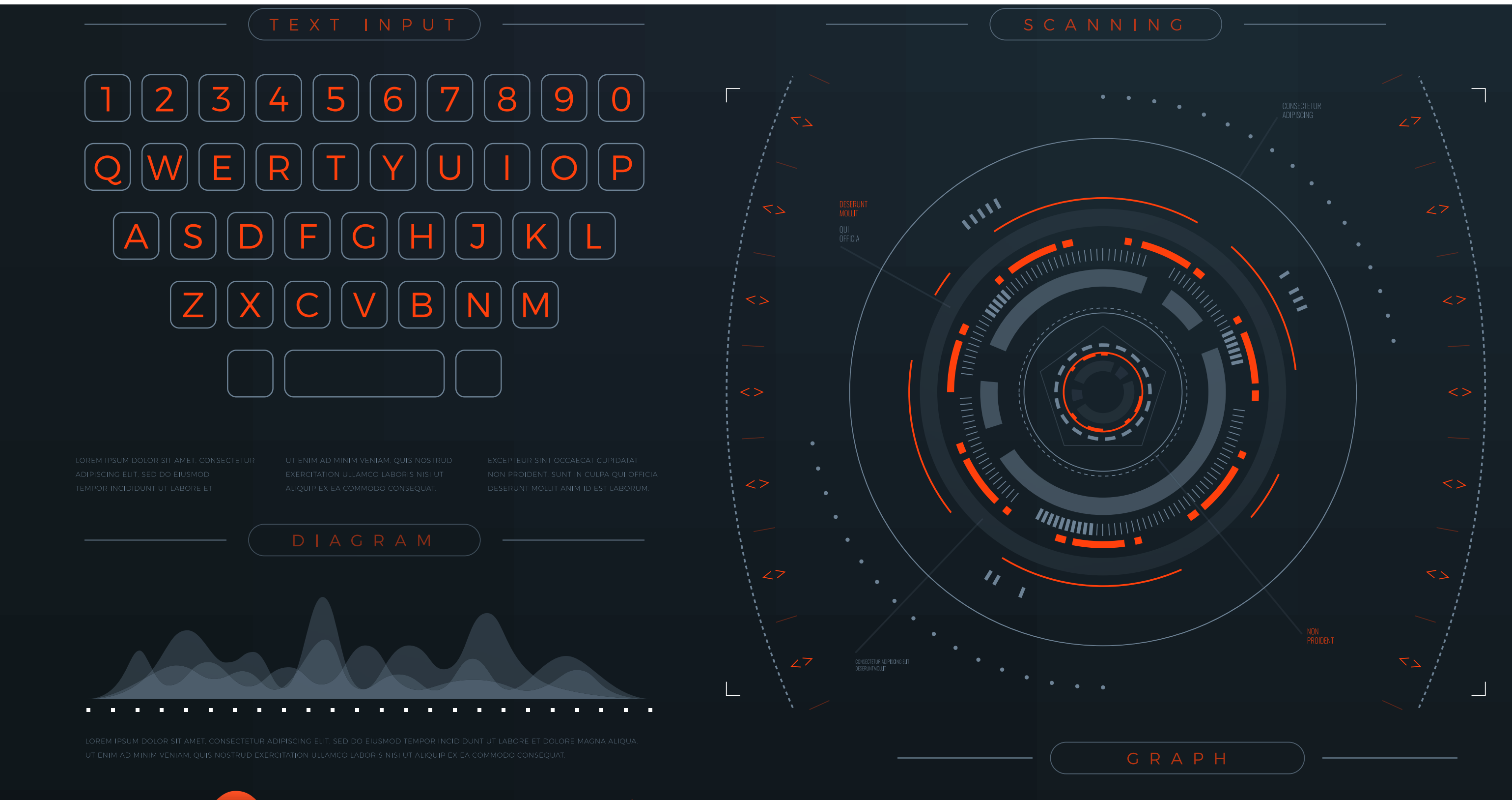
Landlords are required to report their property income for each tax year that ends on 5 April, but many report for the year to 31 March, which is treated as equivalent to 5 April.

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.



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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.

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 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.

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: https://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 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 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 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.


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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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