HM Revenue & Customs

Making Tax Digital:

Bringing business tax into the digital age

Consultation document

Publication date: 15 August 2016

Closing date for comments: 7 November 2016

Subject of this consultation:	At Autumn Statement 2015, the government announced that, by 2020, it would require most businesses, self-employed people and landlords to keep track of their tax affairs digitally and update HM Revenue and Customs (HMRC) at least quarterly via their digital tax account. This consultation considers in more detail how these new processes should operate.
Scope of this consultation:	This consultation outlines reforms that will apply to all businesses, self-employed people and landlords (unless expressly exempted), but it focuses primarily on the unincorporated sector.
Who should read this:	All businesses, self-employed people and landlords with income tax, national insurance, VAT or corporation tax obligations will be affected by these proposals. As well as those affected, we would also particularly like to hear from agents, business representative bodies, software developers and insolvency practitioners.
Duration:	The consultation will run for 12 weeks from 15 August 2016 to 7 November 2016.
Lead official:	Jeff Worrell, HMRC Transformation
How to respond or enquire about this consultation:	Any responses or queries about this consultation should be sent to: HM Revenue and Customs Making Tax Digital for Business Policy Team Room 3C/12 100 Parliament Street London SW1A 2BQ or by email to makingtaxdigital.consultations@hmrc.gsi.gov.uk
Additional ways to be involved:	HMRC welcomes discussions with interested parties, especially businesses, agents and their representatives. If you would like to meet with HMRC to discuss these proposals, please contact us using the details above.
After the consultation:	HMRC will publish a response to this consultation as soon as possible after the consultation closes, followed by draft legislation to enable the first phase of these reforms.
Getting to this stage:	The government published a Making Tax Digital roadmap in December 2015 outlining its wider plans to end the tax return.
Previous engagement:	HMRC have consulted extensively with businesses, agents and their representative bodies in developing these proposals. Parliament also debated parts of these reforms on 25 January 2016.

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On request this document can be produced in Welsh and alternate formats including large print, audio and Braille format

Foreword

Freeing businesses from red tape and allowing them to flourish is a central part of our long-term economic plan for Britain. Businesses want a simpler tax system.

This is why at the 2015 Spending Review the government announced it would invest £1.3bn to transform HMRC into one of the most digitally advanced tax administrations in the world. We want to create something that is more effective, more efficient and easier for taxpayers.

Making Tax Digital is at the heart of this transformation. All individuals and small businesses will have access to simple, secure and personalised digital tax accounts. By 2020, we will have abolished the tax return entirely. Most businesses, self-employed people and landlords will need to keep records digitally and will update HMRC more frequently than is currently the case.

For the majority of businesses, the transition to the new system will be straightforward. Many businesses are already using digital tools. For those businesses who aren't already keeping records digitally, there will be free software and straightforward advice on how to use it. The small minority who genuinely cannot use digital tools will not have to do so. And these reforms will not apply to unincorporated businesses and landlords with an annual income of below £10,000.

I hope that this will allay some concerns. There will be no requirement to draw up a set of accounts each quarter. This reform does not mean 'four tax returns a year'. In fact, it will eliminate the burdensome annual return and simplify tax for businesses.

This consultation document sets out how digital record keeping and regular updates will work in practice. We welcome the views of all stakeholders on the how these reforms can best be implemented. We are keen to listen and work with all those affected to ensure that these reforms are successful.

These reforms are ambitious and radical. I do not underestimate the scale of the change involved. This is why we are consulting widely and the reforms are being introduced gradually. By consulting and engaging with interested parties, we can get these reforms right and ensure Making Tax Digital delivers benefits for all.

Jane Ellison

1. Introduction

1.1. In December 2015 the government published the Making Tax Digital roadmap. This set out the government's plans to make fundamental changes to the tax system – transforming tax administration by 2020 so it is more effective, more efficient and simpler for taxpayers. Making Tax Digital (MTD) will see the introduction of simple, secure and personalised digital tax accounts for businesses and individuals. It will replace existing complex, costly and time consuming tax processes and lead to the abolition of the annual tax return.

1.2. There is still a lot to design and develop before 2020 and it is important for us to do this hand in hand with our customers and those impacted by these changes. We want to design the tax system around the people it affects and we welcome your input about how we can best achieve that. So we have launched a package of six MTD consultations, of which this is one. To see the others, please go to MTD consultations.

1.3. This consultation focuses on how we will bring business tax into the digital age. As announced at Autumn Statement 2015, most businesses, self-employed people and landlords will, by 2020, be required to use software or apps ("digital tools") to keep their business records and to provide regular updates of information.

1.4. Taxpayers will be able to view an up to date picture of their tax affairs, providing greater certainty about tax due and entitlements. Targeted guidance and tailored alerts will make them aware of relevant obligations, entitlements and reliefs. Digital record keeping tools will help businesses to manage their affairs effectively and to understand their tax position more easily. Many businesses have told us they want more certainty over their tax bill and don't want to wait until the end of the year, or often longer, to find out how much they have to pay. These changes aim to deliver this certainty for businesses.

1.5. We know that over 90% of agents can and want to use digital services; and 95% already file online. Digital tax accounts will allow agents to view and manage their clients' tax affairs in one place. We recognise the crucial role that agents will play in implementing these reforms; and have engaged extensively with the agent community in developing this document.

1.6. However, we know that going digital will not be an option for some people. We will ensure that those who struggle to engage digitally are protected and helped. Businesses that cannot use digital tools will be entirely exempted from these new processes.

1.7. We also know that MTD while many businesses are already using digital tools, MTD will be a significant change for some. Over the past few months we have listened to the concerns of small businesses and we have now made a number of changes to the proposed design to ease the transition.

Easing the transition to Making Tax Digital

The changes announced in this and related consultations to ease the transition to digital include:

- Exempting more of the smallest unincorporated businesses from the requirement to keep digital records and make regular updates to HMRC. No unincorporated business or landlord with a turnover or gross income from property under £10,000 per annum will have to do this. We will consult further on whether £10,000 is the right threshold for this exemption.
- Deferring the mandatory start of MTD by one year for the next tier of small unincorporated businesses and landlords with annual incomes of above £10,000 but below a threshold to be determined. This will give these businesses extra time to get used to the new requirements. We will consult on what the upper income threshold for this tier should be.
- Financial support to help some businesses make the transition to MTD. We will consult on the support required and what form this should take.
- Consulting on a new points-based penalty system that applies financial penalties only after several failures, relaxing the treatment of one-off errors. There will also be a soft landing on penalties for the first year of a business's MTD obligations.
- Confirming that those businesses that are digitally excluded will be completely exempted from the MTD obligations.
- Consulting on exemptions for charities, Community Amateur Sports Clubs and inviting proposals for exemptions for other groups.
- Allowing more businesses to account for tax based on cash in and cash out, greatly simplifying the accounting they will do in MTD.
- Flexibility for businesses to record reliefs, allowances and accounting adjustments in regular updates only if they want to, delivering on our promise that quarterly updates do not mean "four tax returns a year".
- Confirming that the information to be provided in updates to HMRC is summary totals of the digital record of income and expenditure and not transaction records.
- Simplifying partnership reporting requirements by proposing the abolition of the current requirement on partners to report their individual profit share in an annual tax return.

1.8. We will consulting widely on the details and introducing these reforms gradually. The changes will apply to businesses' Income Tax and National Insurance obligations from April 2018, VAT obligations from April 2019 and Corporation Tax obligations from April 2020.

What we are consulting on

1.9. This consultation provides details of how the processes set out above will operate. To assist in explaining how these new processes will work, it includes examples of what the proposals might look like for a range of small businesses. Given the diversity of the small business population, it is not possible to provide illustrations in relation to every type of business, but the examples should give a sense of what particular elements of the MTD proposals may look like in practice.

Fig 1.1. Introducing the case studies

'Richard' is a self-employed landscape gardener. His business is growing. He has recently crossed the VAT threshold and taken on two employees. He has also appointed 'Alison', an agent, to help him with his tax.

'Eve' is a self-employed carpenter with no employees. She is below the VAT threshold and has been advised to use the accruals approach to accounting.

'Judith' is a child minder providing after school and holiday childcare. Her financial affairs are simple so she has chosen to account for income tax on a cash basis and she is below the VAT threshold. She has no employees.

'The Lunch Box' is a sandwich bar offering a range of lunchtime and afternoon snacks. 'Sylvia', 'Janet' and 'Donna' run the business as a standard partnership, with Sylvia as the nominated partner. The business is VAT registered, they use the accruals approach to accounting, and have three employees.

‘Dimitri’ is a self-employed mechanic who accounts for income tax on a cash basis. He has no employees and is below the VAT threshold. He employs an agent ‘Sarah’ to manage his tax affairs.

‘Jas’ is self-employed, providing maths and physics tuition. He is below the VAT threshold, uses the accruals approach to accounting and has no employees. He has impaired vision and severe rheumatoid arthritis, which make it painful for him to use a computer. He lives in a rural area with limited broadband coverage.

1.10. Below is an example of one such customer’s experience of Making Tax Digital, following its introduction from 2018.

Fig 1.2. A seamless journey for business

Following the introduction of MTD, Richard selects, downloads and registers his chosen software, linking it with his digital tax account. He allows key information from his digital tax account to be fed into the software, making the registration process quick and easy. The software enables Richard to provide his agent Alison with access to his affairs.

Richard chooses to provide his updates to HMRC quarterly. Throughout the first quarter, Richard records the details of all his business income and expenses within the software. At the end of the first quarter, Richard’s software prompts him to update HMRC.

Richard knows that MTD has integrated his record keeping with the process of providing regular updates to HMRC. This means that his software uses the records he keeps to generate his quarterly updates. He checks the update is accurate before he sends it to HMRC. After sending, he receives a message that confirms HMRC have received his update and he now has the benefit of an in-year estimate of his Income Tax and National Insurance contribution position. He does this each quarter.

At the end of his period of account, Richard asks Alison to finalise his Income Tax and National Insurance positions for the tax year. Alison is able to do this through her shared access of his software. Richard can then view his finalised tax positions through the software.

1.11. This consultation focuses on each element of the journey contained within the above example. These elements are explored in detail in the following seven chapters:

- Acquiring Digital Tools – This chapter considers the practical changes required to move from current record keeping and filing requirements to mandatory digital record keeping and updating of information to HMRC using digital tools.

- Digital Record Keeping – This chapter considers how businesses will keep digital records of trading and transactions.

- Establishing Taxable Profit – This chapter considers how the more frequent updates to HMRC will translate into an in-year estimate of the tax due.

- Providing HMRC with Updates – This chapter considers what information businesses will be required to provide to HMRC through the more frequent updates.

- ‘End of Year’ Activity – This chapter explores the potential approaches to how businesses could finalise their tax position at the end of the year or other relevant period.

- Exemptions – This chapter considers what business types should be exempted from these new arrangements.

- Initial Assessment of Impacts - This chapter sets out HMRC’s current assessment of the impacts of the new requirements for businesses, self-employed people and landlords.

1.12. Given the amount of detail to cover, this consultation focuses primarily on unincorporated businesses as they will make the transition to MTD first. It also covers areas relevant to incorporated businesses of all sizes where it is appropriate to do so (e.g. exemptions). It is anticipated that a further discussion document, focusing on the incorporated sector and on the most complex businesses, will be published at a later date.

2. Acquiring Digital Tools

2.1. This chapter considers the practical changes required to move from current record keeping and filing requirements, to record keeping using digital tools and providing regular updates to HMRC. There is currently no consistent approach to record keeping taken by businesses. There is also a mixture of paper and electronic filing for different taxes and duties. Record keeping varies from full real time reconciliation within a software package, to retention of receipts and invoices for the later preparation of a return. Making Tax Digital (MTD) will transform these practices and processes.

2.2. This chapter sets out what HMRC means by “digital tools”, how businesses will choose the right product for them and the guidance and support that HMRC will provide. This includes ensuring the availability of free products for businesses with the most straightforward affairs.

Software requirements and availability

2.3. At Autumn Statement 2015, the government announced that, by 2020, most businesses, self-employed people and landlords would be required to use digital tools, such as software and apps, to keep track of their tax affairs and update HMRC quarterly, or more frequently if they chose to do so, via their digital tax account.

2.4. The case for doing so was threefold: a better experience for the business from the confidence that they had got their tax right, and with that a level of certainty that enabled them to plan their cash flow more effectively; a level playing field for businesses with a significant reduction in the tax gap caused by small business error; and a reduction in the administrative burden (post transition) of dealing with HMRC.

2.5. The decision to mandate digital record keeping and quarterly updating was not taken lightly. HMRC estimates that while around 92% of those running a small business, including the self-employed and landlords, have access to the internet and are using digital tools (for example, apps and social media) in their personal lives, a smaller percentage are using them routinely for their business. So while the change goes with the grain of how those running small businesses are using technology day to day, there is a transition to work through. This transition will include time spent in familiarising themselves with the new digital tools. For some, it could even mean the purchase or upgrade of hardware. Small businesses will need significant support to make the change and there will be some transitional costs to be borne before the ongoing benefits for them come through longer term, although the government intends that there will be free digital tools for the smallest businesses with the simplest tax affairs. These impacts are discussed in further detail in Chapter 8.

2.6. An optional approach to keeping records digitally would have given rise to a number of challenges. In particular, the return on the £1.3bn investment in transforming tax administration would not have been realised as those most motivated to adopt the new processes would be the ones least likely to be making mistakes currently. Businesses would also lose out on the wider benefits package that digital tax accounts will offer. Having a fully digital tax system allows businesses to see a complete financial picture of their tax affairs in one place, in real time, where they can interact digitally at any time and manage all of their liabilities and entitlements. As a result, we believe that the full benefits of digital capability can only be delivered for all parties by mandating the use of digital record keeping software that links to and updates business's digital accounts with HMRC.

2.7. For businesses, well designed software will help deliver greater control, certainty, and confidence over their tax affairs. They will have the ability to receive nudges and prompts that flag up reliefs or allowances to which they may be entitled, and access inbuilt help to enable them to get things right. Formatting built into the software will do much of the work to provide HMRC with the required information for the quarterly updates, so submitting an update will feel very light touch. Depending on what package they choose, businesses will have the option of doing record keeping with their daily work, or on the go. This could be through smartphone apps, for instance.

2.8. Although there is currently no requirement for the prime records of a business to be kept in a digital format, some businesses already choose to maintain their records in that way. This will range from spreadsheets to a fully integrated accounting and tax filing software package, and a range of prices, including some free products.

2.9. As an example, several software suppliers produced simple record keeping applications to meet the simplified accounting and expenses specifications introduced in Finance Act 2013 – and several of those products are free.

2.10. We expect the digital tools produced to meet the requirements of Making Tax Digital (hereafter in this consultation referred to as "MTD-compatible software") to cover a multitude of offerings. It could be any program or combination of programs, operating on a device (whether desk-based computer, or mobile device such as smartphones and tablets) that allows the entry, storage (whether local or in the cloud), and transmission of data, sufficient to meet the minimum requirements discussed in Chapters 3 and 5 of this consultation. As data will be transmitted to HMRC via Application Programming Interfaces (API), the software will need to be capable of capturing and submitting data in specified formats and linking to the relevant API. (An API defines how one application talks to another application, allowing it to access a resource, some data or a service). More about HMRC's API strategy can be found here.

2.11. We recognise that, as a minimum, businesses will require access to the internet in order to transmit data to HMRC and upgrade their software. Further dependencies on the internet, and on broadband speeds, could come from updating digital records, often using cloud based systems. Currently at least 90% of premises in the UK have access to superfast broadband (greater than 24 Megabits per second (Mbps) and this will increase to 95% by the end of 2017. The government has previously supported investment to provide access to basic broadband of 2Mbps for all, which HMRC considers is a speed sufficient to send an update. The Digital Economy Bill, published in July 2016, includes proposals that will give every household and business a new legal right to request an affordable broadband connection from a designated provider, no matter where they live, up to a reasonable cost threshold. The government's ambition is to initially set the minimum speed at 10Mbps. This speed will be increased over time as broadband speeds increase overall.

2.12. HMRC is exploring, with specialists, the role of spreadsheets in business record keeping and their ability to meet the requirements and benefits of MTD-compatible software. We are interested in the views of businesses on how spreadsheets could meet the requirements of MTD as set out in subsequent chapters of this consultation.

Question 1: What are the challenges for businesses that currently keep their records on paper or simple spreadsheets in moving to an integrated software package for record keeping and what further measures or support would help businesses to meet these challenges?

2.13. To assist businesses with the transition to MTD, HMRC will ensure MTD-compatible software products are available to suit the budgets and needs of all businesses, including some free products. We are working with software developers on the provision of new and/or updated products that will meet the requirements of MTD. HMRC already works closely with around 600 software developers across a range of products, helping them bring new and more sophisticated products (including apps) to the market, and has dedicated software support teams assisting both developers and users. Some current products may already provide most of the requirements of MTD and will need minimal enhancement.

2.14. One of the ways we will work with the market is by developing and releasing new APIs to ensure software can communicate with our systems. These will offer richer capabilities that will allow developers to do much more and encourage innovation. This will mean new and better products that will increasingly help businesses to get it right first time. We expect this improved software will allow many businesses to keep their records and provide regular updates to HMRC with the minimum of assistance.

2.15. Businesses will need to use software appropriate to their business requirements. For example, a business that is registered for VAT will need the software to cope with the VAT scheme it uses, or a partnership will need software that can record the partners' details and profit shares. HMRC will engage with software developers to ensure there is a competitive market that offers a choice of products, many serving multiple requirements, to meet those differing needs.

Fig 2.1. Choosing software

Richard heard about the forthcoming MTD requirements from his agent. During the conversation, his agent encouraged Richard to consider which software would best suit him and his business in terms of a range of factors including cost, functionality, and hardware preferences. Richard needed software that could manage both his Income Tax and VAT record keeping and bought a product that could help him categorise his receipts 'on the go' via a separate app on his tablet device.

In contrast, Judith did not want to pay for her software. She regularly accesses the child-minders' online forum for informal advice from others in her line of business, and heard about HMRC's virtual helpline. She went online and got advice from the live web chat. This referred her to guidance on GOV.UK on the range of free software from which she could choose the product that best suited her needs. As a result of the guidance available, Judith chose a free smartphone app as she felt this might be most similar to the smartphone banking app that she already uses to manage her personal finances.

2.16. HMRC recognises how important it is to get the views and expertise from the agent population on the range and extent of software products. Many agents currently use practitioner accounting software to prepare and electronically file annual accounts and tax returns on behalf of their clients, and are often instrumental in setting up and advising their clients on record-keeping. We are actively seeking their input into this consultation, in respect of both their needs and those of their clients.

2.17. Most software providers will deliver any necessary updates to the software directly to the customer via a download, or automatically through cloud technology which delivers instant updates the next time a user goes online, minimising any activity required by the customer to ensure they are using the most recent version.

2.18. The software will need to be capable of linking up to HMRC's relevant APIs for successful and secure transmission of data. There will be substantial testing of the compatibility of software products with the APIs to ensure it can effectively communicate with HMRC systems, and meets HMRC's security standards. Once the software has compiled the relevant data, businesses or their agents will be able to simply feed it directly into HMRC systems, using the API, via their computers, tablets or smartphones. We expect updating HMRC directly in this way will be secure, light-touch and far less burdensome than the tax returns of today.

2.19. HMRC will provide:

- Guidance on what a business should look for in commercially available products;
- A list of available products that can interact with HMRC systems; and
- Regular performance metrics relating to the software packages and apps, to assist businesses in deciding the suitability and reliability of commercially available products.

2.20. We will make sure guidance and information is readily accessible through pages on GOV.UK, with links to up-to-date data and advice covering the software choices available.

Question 2: What information and guidance would you find helpful in choosing the appropriate software for your business?

2.21. HMRC recognises that for smaller businesses in particular there are some concerns around the cost of purchasing MTD-compatible software. The government is committed to ensuring a free product is available for businesses with the most straightforward affairs. HMRC has clearly signalled to developers that free software products, with free updates, must be available alongside a breadth of additional products catering for the wider market.

2.22. HMRC has no plans to offer its own free software product. By indicating that HMRC does not intend to provide its own free software product for MTD, developers have been reassured that their investment decisions on providing no cost and low cost software products will be unaffected by competing HMRC products. MTD will also transform the digital market, bringing increased opportunities for current and future software developers to offer a range of services, software options and functionality to businesses. This will lead to a highly competitive market, which will impact on the costs of purchasable products.

2.23. We recognise that some businesses may have particular issues with the costs of investing in new IT, software (where free software offers insufficient functionality for the business) and/or training. We would therefore welcome views on what financial support might be reasonable for the government to provide, to whom such support should be aimed, and the appropriate form for delivering such support (for example, whether the support could be provided best through the tax system).

Question 3: What types of business should a free software product cater for? What functionality would be necessary in a free software product?

Question 4: What level of financial support might it be reasonable for the government to provide towards investing in new IT, software or training, to

whom should such support be aimed, and what is the most appropriate form for delivering such support?

Ability to acquire and use digital tools

2.24. A large proportion of businesses are already transacting with HMRC digitally, with 99% of VAT and 98% of Company Tax returns filed online, and although there is no mandatory requirement to file Self Assessment tax returns online, 85% are currently delivered in this way. More than four million small businesses have already logged on to their digital tax account. In general, businesses in the UK have a high level of digital engagement, although this varies according to size. Research by the Department for Business Innovation and Skills in 2015 found that 97% of small businesses (defined here as 10-49 employees) and 92% of micro businesses (1-9 employees) had access to the internet at work. For businesses with no employees, though, the rate fell to 78%, although 86% of these said they did have internet access at home. HMRC acknowledges that some of these customers will need extra support in moving towards confident use of digital tools in their business. (Those classed as 'digitally excluded' are discussed in Chapter 7.)

2.25. Businesses with a high level of digital confidence may also benefit from some forms of support through the transition to the new requirements under MTD.

2.26. Agents are generally very confident in their use of the internet and engaging digitally with HMRC. Many welcome the provision of additional online services. However some have told HMRC they would need additional support for new digital services.

2.27. HMRC already provides a range of digital support tools and through its digital support strategy has been actively addressing issues of digital inclusion and assistance. It is continuing to develop a broad range of digital support products and services, to help and reassure businesses when dealing with HMRC. For the transition to MTD, we are using targeted customer research to understand how to ensure we cater for businesses with different needs, to give them the knowledge, skills and confidence to manage their tax affairs using digital tools.

2.28. We recognise that different levels of support will be needed and our response will need to be in a variety of channels. For digitally confident businesses able to self-serve, we will make available information and guides covering MTD on the GOV.UK pages and as part of a wider marketing campaign. Our work with software developers is also looking at increased opportunities to provide help and guidance as part and parcel of the software packages.

2.29. HMRC is a regular user of social media and has already established a Twitter account tailored to the needs of small businesses. We expect this to be regularly added to, to address emerging MTD needs. Content-sharing platforms such as YouTube will increasingly be used to include information on the new tools and requirements and an animation about MTD has already been released. Both live and recorded webinars and e-learning packages will be available at times to suit businesses. HMRC has already developed smartphone apps with the private sector which help businesses maintain an accurate record of their business income and expenditure.

2.30. We know some businesses will want to get in touch with HMRC direct and for them our staff will tailor their advice to ensure customers get the best help for their needs. We will be developing our offering here, to include:

- Webchat facilities;
- Virtual assistants (such as our “Ask Ruth” service);
- Instant messaging;
- Telephony via the new contact platform;
- HMRC’s Needs Enhanced Support Service;
- Facilitating the use of trusted helpers and intermediaries (friends/family/agents); and
- Working with charities, local libraries or other community locations to provide assistance and WIFI facilities.

2.31. In order to offer the best service we can to our customers we need to know what you would find most useful, and invite your ideas on this.

Fig 2.2. Gaining additional digital assistance

Judith lacks confidence in managing her tax affairs and whilst able to access digital software, she is concerned that she will not know what is required of her or what she needs to do. Having previously used HMRC’s online help in choosing her software, she goes online again to try to find guidance for registering software and accessing the Business Tax Account. She finds a link to the virtual assistant on the HMRC website, which she accesses. The virtual assistant answers her question almost immediately and provides a link to the appropriate guidance, which saves her spending any further time searching. The guidance provides Judith with a step by step guide to registering her software with her digital tax account. Having followed the instructions to register she receives a text message confirming she has done it correctly, which she finds reassuring.

Since choosing and setting up her software, Judith has regularly referred her queries around updating to the 24/7 virtual assistant, which she can access from her smartphone allowing her to get a quick answer to her query. On only a couple of occasions, the virtual assistant has not provided her with information specific to her circumstances. On both of these occasions, Judith accessed HMRC’s webchat facility to ask more detailed questions. She found the answers really helpful and has referred a number of her friends to use the webchat rather than telephone to contact HMRC with their own queries.

Question 5: What other forms of support would help to make the transition to Making Tax Digital easier?

Linking software to your digital account

2.32. As at present, customers will continue to enrol for tax services online through the secure government gateway. HMRC is working with other government departments to ensure the continued security of the gateway, taking advantage of technological developments to improve the service.

2.33. Third party software developers (as well as any businesses with in-house or self-built software products) will need to register with HMRC in order to use the appropriate HMRC interfaces (APIs). HMRC sets the security specification and standards of the interfaces, and the developer will need to adhere to these for data to be successfully delivered through the gateway. Businesses will authorise their software with HMRC to allow it to submit data on their behalf. Each time a business wants to submit data, HMRC will ensure the continued security and identity of the software and allow the submission to take place. HMRC will approve access for software for an agreed period of time, with a simple renewal process thereafter.

Fig 2.3. Registering software with HMRC

Having selected and purchased his software, Richard is required to enter his business contact details and create a username and password.

Once logged into his software, Richard is prompted to enter his Gateway login details in order to link his software with his digital tax account. He receives a confirmation text and email to confirm that he has successfully registered his software with his digital tax account, which reassures Richard that it has worked.

As a first time user, there are a few additional steps he must undertake to ensure a streamlined experience in managing his tax affairs through the software in future. First, Richard needs to grant permission for the software to pass his information and data to HMRC, which he does by clicking on the 'approve' button presented. Once set up, Richard is invited to review and update his personal information, where he notices that his Unique Taxpayer Reference (UTR) and National Insurance Number are amongst his personal details that have been pre-populated within his software. He cross references the information with his own records and is reassured that they match.

Richard next chooses to authorise his agent to access his account and manage his tax affairs within his software. He selects the 'invite accountant' option and enters his agent's details. His agent then receives an automated email notifying her of the registration and invitation to access.

2.34. As now, businesses will continue to be responsible for the security of their own operating systems and software packages, including the installation, updating and day to day use of software packages, by not divulging passwords, preventing virus and malware etc. There is currently guidance on keeping safe online on GOV.UK pages. HMRC will review the need to provide additional guidance to support those customers who may not previously have had to consider these issues.

2.35. HMRC currently has stringent security standards applying whenever there are digital submissions and will continue to reinforce their robustness and explore new and cutting edge security technology.

2.36. HMRC currently handles huge amounts of customer sensitive data. Once data has been uploaded from a business's software package to HMRC systems, the security of that data will be covered by our data protocol guidelines, which include compliance with the Data Protection Act, Freedom of Information Act, financial accreditation standards and our own additional internal standards.

Question 6: What facilities would make it easier and more secure for businesses to enrol for Making Tax Digital and use software regularly?

3. Digital Record Keeping

3.1. This chapter considers how businesses will keep digital records of trading and transactions and categorise their expenses with help from prompts and guidance from their software.

3.2. By 2020, most businesses, self-employed people and landlords will be required to use digital tools to keep records of their income and expenses. For businesses with the simplest affairs, the software will be free. Businesses will use software to integrate tax into their ordinary day to day activity.

3.3. Sophisticated software products may have the functionality to connect to third party data sources such as online vendors and banks, if businesses wish, to ease the process of making accounting entries. However, nothing in this consultation document proposes giving HMRC powers to access business's bank accounts.

3.4. The business software will highlight possible errors and prompt for information that might otherwise be overlooked. It will also offer simple guidance on the tax treatment of income and expenses.

Digital evidence of transactions and trading

3.5. Evidence of transactions and trading – copies of invoices, receipts and cash takings records – are currently required as part of the record keeping obligations; these requirements will not change. Software will be available that makes it easy to keep evidence of transactions and trading digitally. It is likely that software functionality will be available to scan paper invoices and receipts into the software, using a smartphone camera. These scanned records would be readable by the software.

3.6. There is a current legal requirement to keep records for tax purposes, although the legislative requirements differ between profits based taxes and VAT. However, in each the requirements are broadly drafted and require companies or persons in business to keep records of receipts and expenses and the matters to which they relate. These legal requirements will remain broadly unchanged and no additional records will need to be kept.

3.7. There are more stringent requirements for VAT registered businesses reflecting the greater need to be able to trace individual transactions and determine the VAT liability. These requirements include, amongst others, the need for a VAT account, a Bad Debt account, documentation relating to imports or exports, or to acquisitions or supplies from or to other EU states. These regulations also require that copies all VAT invoices issued or received must be kept and specify the detail that must be shown on a VAT invoice. These VAT transaction evidence and record keeping requirements will be retained.

3.8. We anticipate that many businesses will choose to keep evidence of transactions – digital copies of invoices and receipts – in the software. If the business issues invoices or receipts these could be automatically generated by the software. Evidence of expenses could be scanned into apps and smartphones, if it had not already been received digitally, otherwise manual entries would be required. Retailer's cash takings may need to be recorded manually into the software.

Question 7: Do you have any comments about the practicalities of keeping evidence of transactions and trading when using digital tools?

Transaction entries

3.9. For many businesses, we expect that the scanned evidence of transactions will be processed by the software which will extract the data and automate the accounting entries. However, in cases where a paper invoice has to be entered manually, because, for example, it was too faint or damaged to be scanned, then the user would need to ensure that all relevant data fields have been completed. Entries relating to some allowances, reliefs or tax adjustments may also need to be entered into the software manually.

3.10. In many cases, software will have greater capabilities and many more data fields depending on the requirements of the business. This remainder of this section, however, seeks to address the minimum requirement for the recording of transactions.

3.11. HMRC's preferred approach for unincorporated businesses is that the following data fields are completed for each receipt or expense item. This is the minimum required data to identify and categorise each transaction:

- invoice date and payment received date if cash basis
- invoice value and payment received value if cash basis[1]
- income or expense category
- deducted amount/ percentage for expenses.

3.12. Retailers will record their expenses as above, but those who have high volume, low value cash transactions (and who do not have the means to record every transaction) will be able as an alternative to complete the following minimum data fields in relation to their income:

- trading date
- gross cash takings
- income category.

[1] An overview of the eligibility criteria for unincorporated businesses to account for income tax on a cash basis are provided in Chapter 4: Establishing Taxable Profit.

Fig 3.1 Capturing digital evidence of transactions

Eve used to keep her receipts and paperwork in a drawer, pulling it all out once a year when completing her return. It took a lot of time to find, sort, categorise and enter in one go, Eve had forgotten what some receipts were for, and was aware that some receipts for both income and expenses were either not kept or lost during the year.

With the app on her smartphone, she is now able to capture her receipts closer to real time either at the checkout or when she gets back to her van. Most of the time she quickly photos her receipts when she gets them, capturing them within her software which stores an electronic image in the cloud storage. Some stores that she uses to buy materials send her an electronic receipt, which she is quickly able to file in her software.

When captured in her software, her app populates automatically with amounts recognised from each receipt. In these cases she is prompted to confirm that all amounts are business related and for those that are, what expense categories they come under. After a short time of keeping her records in this way the software automatically categorises according to her most often used expense types, and where she disagrees with the categorisation she is able to select an alternative within the software.

For those amounts not automatically recognised, for example because the printing is not clear or the receipt has been damaged, Eve can easily add any missing information in the app.

Although Eve sometimes falls behind, she quickly catches up and enters any outstanding receipts when she adds her invoiced amounts into her software at a time that suits her. Overall, after a short adjustment period, Eve found she spent less time on her record keeping because it was part of her routine and she had more confidence that her tax was right.

3.13. Businesses that choose to use simplified expense reporting will also need to keep records of, for example, business mileage or time spent working from home.

Question 8: Do you agree with the minimum transaction data fields proposed for trading businesses, including retailers? What other data fields might the record keeping software usefully include as a minimum?

3.14. Accruals accounting is dealt with in more detail in Chapter 4, but those businesses who take the option of making in-year accruals adjustments, will need software that has the additional functionality to allow opening and closing balances (e.g. stock) over longer periods than the period the transaction falls into, so that profits estimates remain accurate.

3.15. VAT registered businesses will need software that handles both VAT accounting (where the current accounting requirements will remain) and profits tax accounting. For VAT transactions, therefore, the VAT rate and value will also be required to correctly calculate the VAT liability.

3.16. The software will also need to be capable of handling any special scheme calculations that are necessary. For the VAT Flat Rate Scheme, businesses would still be required to keep digital records in the software, which would then apply the relevant percentage to total income to calculate their VAT liability.

Question 9: Do you have any comments about reflecting the current VAT requirements in MTD-compatible software?

3.17. Further information will need to be captured by record keeping software packages in specific circumstances, for example, for those who have property income or who have made a capital gain.

3.18. For landlords, the following additional information would need to be captured:

- property address details
- income and expenses attributable to each property.

3.19. For capital gains on business assets, the data to be captured would be:

- dates of acquisition and disposal
- values at acquisition and disposal.

3.20. In many cases the software developers will reduce the user workload. For example, a software package used by a landlord might ask about property income values at first enrolment; this information would not need to be re-entered at each update unless there was a change to report.

Question 10: Do you have any comments on the additional data capture requirements for property income and capital gains?

Income & expense categories

3.21. Tax legislation contains a variety of rules on allowable and non-allowable expenses. To generate tax estimates, therefore, transactions will need to be categorised in the accounting software into income and expense types – for example advertising or professional expenses. Businesses will be able to categorise expenses using Making Tax Digital (MTD) compatible software and they will be able to categorise all of the most common types of transaction expenses in even the most basic products. Recording and categorising transactions will need to be done once only in the software, because the application will be able to use the data for both profits tax estimates and any VAT liability (if VAT registered).

3.22. Existing software is capable, after prompting in the first instance, of classifying transaction data and assigning this to particular categories. For many businesses, depending on the sophistication of their software, after an initial phase of assigning transactions to categories, the software should recognise regular expenses (e.g. from the supplier details) and automatically assign them, reducing user workload.

3.23. As part of their record keeping, businesses will categorise some expenses that are generally not allowable at all for tax purposes – for example ‘business entertaining’ – and the software will aid accuracy by ensuring that they are not deducted from taxable income. For other categories – for example telephone expenses – the proportion that can be allowed against tax varies with individual circumstances and this proportion will need to be entered by the software user. Here, businesses will often be able to estimate the deductible percentage at the outset of the year, and confirm it later, rather than have to apply it to individual transactions, again reducing the work that needs to be done on each entry.

3.24. Software products are likely to contain detailed levels of categorisation according to market and user requirements. However, HMRC believes it will be necessary to specify a minimum level of categorisation for MTD-compatible software. One possible starting point for this is the categories contained in the current SA103F supplementary page to the Self Assessment tax return which will be familiar to many unincorporated businesses. These include categorisations for business turnover, other income and various expense items, such as telephone expenses, accountancy and professional fees etc. The SA103F categories are listed at Annex A in this document.

3.25. Categories additional to those described in Annex A may be necessary to facilitate particular issues or groups. For example, a category specific to cash basis assets would enable cash basis businesses to record and report asset items at the time they occur, in the same way as other income or assets, rather than make adjustments later. Categories for capital gains and property income would also be needed. Additional sub-categories for car expenses and for home use expenses would reduce the need for alerts around including motoring expenses, if mileage allowance had already been claimed.

Question 11: What should the minimum categorisation in the software be? Would additional sub-categories be useful?

Question 12: Do you have any comments on how businesses should reflect transactions and expenditure with non-deductible elements in the software?

Software tax guidance (“prompts and nudges”)

3.26. MTD introduces ambitious changes and HMRC do not underestimate the scale of the change involved for most businesses. To help with the transition to digital record-keeping, businesses will have the software and support they need to help them get their tax affairs right first time. Accounting software can already provide guidance on tax matters and this feature will be helpful to businesses seeking to understand, for example, which expenses they may (or cannot) deduct, and allow them to be more confident that information provided is accurate. This digital assistance will be integrated with ways to contact HMRC, such as through secure web chats, and other HMRC support services such as online tutorials and guidance.

3.27. The use of software itself will reduce arithmetic and/or transposition errors. HMRC will work with software developers, helping them develop capabilities to highlight entries and figures that appear to be incorrect and nudge users who seem to be making common errors or prompt users for information that appears to be missing or incomplete. In particular, the use of prompts when categorising expenses as allowable for tax purposes will help businesses receive targeted guidance rather than have to search for it.

3.28. As part of this programme of work, HMRC will give software developers standardised information derived from its compliance programme and customer research about the most common error types so that they can incorporate the most helpful prompts and nudges into the software.

Fig 3.2 Prompts and nudges

MTD-compatible software will incorporate a range of nudges and prompts, for example in the form of pop-ups and questions within the software, which flag to the business any areas where a potential inconsistency or error is being made. In such instances, the business will be asked within the software to double check they are happy with the figures they are updating HMRC with.

During the year Richard buys a new van for use in his business, he isn’t aware that he is entitled to claim capital allowances against the purchase. Before MTD he would not have realised this entitlement and would not therefore have claimed part of the value of the van from his profits before paying his tax. However, when entering his van purchase into his MTD-compatible software, a pop-up message advises him of the capital allowances available, with a targeted link to further online guidance available should he wish to find out more. On entering the cost of the van, the software automatically calculates the capital allowance and reflects it in his year to date tax figure.

When Eve completes her yearly accounts, she includes depreciation of her business equipment as an allowable expense. Before MTD she would have used the accounts information to complete her tax return, and might not have realised that depreciation is not tax deductible. She might therefore have included it as part of total expenses and forgotten to add the depreciation value back into her tax calculations.

This mistake is likely to be considered by HMRC as Failure to Take Reasonable Care because Eve should know that depreciation is not tax deductible. If found as part of an enquiry, Eve would have been liable to tax and interest.

However, within MTD the software will pick up that depreciation was included in the accounts, and prompt Eve to add the depreciation back into her tax calculations, removing the error and helping her get her tax right.

3.29. In this way businesses' accounting records will already have been through at least one level of checking by the time they come to submit the information to HMRC. Over time, as improved versions of the prompts and nudges are released to the industry, businesses data should show increasing levels of accuracy. HMRC wants to seek views on the initial versions of the software guidance.

Question 13: What prompts and nudges would be most useful to businesses?

4. Establishing Taxable Profit

4.1. This chapter considers how Making Tax Digital (MTD) will help businesses establish their taxable profit. In particular, it explores when businesses should record accounting and tax adjustments for the purposes of arriving at a taxable profit and how business should reflect reliefs and allowances.

4.2. It is important to note that businesses will continue to calculate their VAT liability quarterly. The introduction of MTD will not change the current approach to calculating a business's VAT liability.

4.3. We know that many businesses want a clearer view, during the year, of their tax affairs, rather than waiting until many months after the end of their period of account. We are also aware that there is concern about the wide range of adjustments that some businesses are required to make to arrive at a taxable profit and how and when these will be taken into account under MTD.

4.4. We have listened to these concerns and have addressed them by providing businesses with as much flexibility as possible around when they can make these adjustments. For those who typically draw up a formal set of accounts once a year, perhaps using an agent to help them do this, that choice will remain. There will be no requirement to draw up four sets of accounts a year that meet all tax requirements and accounting standards. Equally, however, those businesses who want to leverage the opportunity offered by MTD to have greater certainty in-year of their tax position, or for whom having short periods of account suits their business model, will be able to do just that.

4.5. The previous chapter outlined the requirement for business to maintain digital records. This provides the opportunity to begin to give an in-year estimate of their Income Tax and National Insurance Contributions (NICs) position. It will be 'estimated' because the annual nature of profit-based taxes remains unchanged. The final position for such taxes and NICs can only be established after the end of the period(s) of accounts that end in the relevant tax year and once all relevant adjustments relating to those periods have been made. As is the case now, business will also be able to see their actual VAT liability.

4.6. Chapter 5 explores what information might be sent to HMRC as part of the regular update process. HMRC will share with the business any data relevant to the calculation of its income tax and NICs position. This will be either through their digital tax account or directly into its software. For profits-based taxes, this will give businesses greater clarity of their in-year tax and NICs position, providing a more detailed picture of their affairs.

Recording accounting adjustments

Cash Basis Accounting for Income Tax

4.7. Broadly, unincorporated businesses with annual turnover below the VAT registration threshold (currently, £83,000) are eligible to use the cash basis method of accounting for Income Tax. This allows them to account for their income and expenses when they actually receive payment or when they actually pay for an expense. There is no requirement to adjust for accruals items and most capital expenditure is treated as deductible expenses. A business can continue to use this 'cash basis' whilst their turnover remains below twice the level of the VAT threshold i.e. £166,000 currently.

4.8. More than a million businesses have already opted to account for Income Tax on a cash basis. We estimate that, under the current rules, a further two million businesses may be eligible to do so.

4.9. As part of the Chancellor's commitment to simplify Income Tax for businesses, and to facilitate the operation of MTD, two consultation documents were published alongside this consultation: Simplifying tax for unincorporated businesses and Simplified cash basis for unincorporated property businesses. These explore whether to increase the annual turnover limit for trading businesses which wish to use the cash basis of accounting for Income Tax and whether to also allow property businesses to use the cash basis of accounting for Income Tax. These measures would increase the number of businesses that are eligible to use this cash basis, supporting the aims of MTD. We encourage you to view and comment on these consultations.

4.10. Businesses that use this cash basis will find providing regular updates to HMRC the most straightforward. The updates will provide an accurate estimate of their in-year Income Tax and NICs position. Businesses will have recorded details of their income and expenses as they actually receive payment or pay for an expense. The updates will build a picture of their taxable profit. The alignment between MTD and cash basis may encourage more businesses to adopt this cash basis.

4.11. MTD does not affect the cash basis of accounting that businesses may use to account for VAT.

Accruals Basis Accounting

4.12. All other businesses will calculate their taxable profit, and where required prepare accounts, in accordance with Generally Accepted Accounting Practice (GAAP).

4.13. Preparing accounts in accordance with GAAP requires businesses to follow the accruals basis. Accruals is an accounting concept requiring income and expenses to be recognised in the period to which they relate.

4.14. As part of this, a business will establish opening balances for the relevant period of account in respect of a number of different ledgers, for example debtors, creditors, capital assets and stock. They update these balances with any transactions and make appropriate adjustments during the period. HMRC understands that business will often have to consider whether an adjustment is appropriate or necessary. Many will use an agent to help them do this.

4.15. In order to calculate an accounting profit or loss in accordance with GAAP, it is then necessary to make further adjustments. For unincorporated businesses, these usually include:

- stock adjustments;
- adjustments for profits where contracts span the period end;
- sales, purchases and stock cut off adjustments;
- adjustments in respect of provisions for bad debts; and
- adjustments for accruals and prepayments.

4.16. A separate consultation document, Simplifying tax for unincorporated businesses considers whether the burden of calculating profits in accordance with GAAP can be reduced for unincorporated businesses by removing some of the accounting requirements but still delivering an acceptable calculation of profits for tax purposes for both the business and HMRC. Those proposals are not aimed at companies – and HMRC recognises that companies will often need to make a number of other accounting adjustments in addition to the ones mentioned above.

4.17. We know that some unincorporated businesses will already be using software for their accounting needs. We understand there is a wide range of products available and they are likely to have some or all of the following components:

- the ability to produce a set of annual accounts;
- the ability to produce a computation for profit taxes and/or VAT;
- the ability to 'file' online; and
- the ability to provide management information to those running the business

4.18. All products will consist of a series of ledgers and a process for updating these. At its simplest, there will be two ledgers, one for cash in and one for cash out. For accruals accounting, the structure of ledgers and sub-ledgers will be more complex and the exact nature will vary from business to business.

4.19. At the beginning of each period, the opening balances in many of the ledgers (such as debtors, creditors, stock and capital assets) will have assigned values. During the period, transactions will be posted to the appropriate ledger. Some businesses will already be making some adjustments to these values during the year to facilitate the production of management accounts. This will form the foundations of the preparation of their annual accounts.

4.20. An example of an adjustment that many businesses would currently make to arrive at their taxable profit is stock adjustment. Business would typically conduct a 'stocktake' at the end of each period. Although some, such as retail businesses, may do this more frequently.

4.21. We are keen to ensure that MTD does not place any new requirements on businesses in respect of these records. Where businesses are using software, we want to align with the existing records that they prepare and maintain. Therefore, HMRC is keen to understand which accounting adjustments businesses, or their agents, consider have the greatest impact on their calculation of taxable profit and the particular challenges recording these more frequently would present. Subject to that, HMRC's preferred approach would be for businesses to have the flexibility to make in-year accruals adjustments if they so wish – but there will be no requirement placed upon businesses to do this.

Fig 4.1. In- year adjustments

Eve, the carpenter, has not engaged an accountant. Instead, she relies on her uncle who is a retired bookkeeper. Her business is growing and she may soon need a bank loan to finance her plans to expand.

Her uncle has advised Eve that she should be accounting on an accruals basis, as the bank will expect to see accounts drawn up in this way before it will offer financing. Eve's uncle has told her that the software she has acquired will help her to do this. When using her software, it provides a personalised link to online guidance on accruals. The guidance explains that, for her, this means recording the cost of the stock she has received to build the new furniture her client has asked for even though she has not yet paid for the materials, which the software then allows her to do. Eve is further reassured when she later checks what she has done with her uncle.

In the subsequent quarter, Eve sells the furniture and she knows she must also record this income in the relevant period. Eve continues to do this throughout her period of account.

Using the help available through her software, Eve decides not to reflect the necessary adjustments for 'closing' stock that she has accumulated throughout the year until the end of her period of account. She understands that because of this, any in-year estimate of tax and NICs will be less accurate.

4.22. This approach will minimise the impact on businesses by aligning with their existing use of software. It provides them the opportunity to consider the best approach to recording these adjustments in-year. This balances any burden of making these adjustments in-year against the fact that recording them in the software will improve the accuracy of their tax estimate and could reduce some of the work required at the end of their period of account.

Question 14: Do you agree that businesses should have the choice as to when to record accounting adjustments?

Recording tax adjustments

4.23. At present, once businesses have made the necessary accounting adjustments to arrive at a profit or loss figure, they then make a number of adjustments required or authorised by tax law. For example, these may include:

- disallowance of depreciation;
- disallowance of certain expenses e.g. entertaining, fines, penalties and bonuses not paid within nine months of year-end;
- add back of non-allowable provisions; and
- pension scheme adjustments.

4.24. Complex unincorporated businesses and companies may make many other tax adjustments to arrive at a taxable profit.

4.25. Given that these adjustments will affect the calculation of taxable profit, we need to consider when a business should record them.

4.26. It is clear that record-keeping software will be able to do much of the work here. This provides an opportunity to change the time at which tax adjustments are traditionally made. As and when expenditure is captured in the software, it will be categorised. This will enable tax adjustments for items such as depreciation and non-allowable expenses to be made automatically.

4.27. However, HMRC wants to provide the maximum flexibility possible to businesses. We understand that some businesses will not consider some of the more complex tax adjustments that need to be made until the end of their period of account, and an agent may do some of these for them. HMRC's preferred approach is to allow flexibility to businesses as to when more complex tax adjustments are made, while noting that a benefit of performing these earlier would be to provide the business with a more accurate in-year tax estimate.

Reliefs and allowances

4.28. The legislation governing the taxation of business profits includes a wide range of reliefs, allowances and credits. Currently, some of these are claimed as part of a tax return whilst others can be claimed after a return is due.

4.29. These reliefs and allowances have a significant impact on the tax liability of businesses. We are keen to adopt an approach that empowers business to understand the effect of reliefs and allowances on their estimated Income Tax and NICs liability, as soon as possible. However, we need to balance this with the fact that many businesses will seek advice on whether to claim reliefs and allowances and that certain reliefs would be difficult to include without the full picture for the period.

4.30. Therefore, HMRC's preferred approach to reliefs and allowances would give businesses the flexibility to project the effect of tax reliefs and allowances in-year, against the actual expenditure or profit to which they relate. This would give the choice to the business about when to recognise these reliefs and allowances.

4.31. Businesses may wish to indicate in their software where they think a claim to a relief or allowance is likely. For example, they would indicate that the purchase of an asset, kept for use within their business, might be eligible for Annual Investment Allowance (AIA); reducing their estimated profits based tax and NICs. Alternatively, they could wait until the end of their period and then claim the AIA. This would reduce the accuracy of their in-year tax estimate but might be a preferred option for some business, particularly those using agents.

4.32. The advantages of this approach are that it provides maximum flexibility for businesses. Those who want to have increased certainty of their in-year position are able to include relevant reliefs and allowance. They will instantly see the effect that this has on their tax estimate. Those who wish to continue to do this at the end of their period will be able to do so.

4.33. It also ensures businesses continue to have the opportunity to seek advice where they are unclear on whether any reliefs or allowances may be applicable.

4.34. HMRC understands that the ability to indicate, in-year, the likely treatment of reliefs and allowances is not routinely available. If HMRC adopts its preferred approach, we will explore with the software industry how much of this functionality could be included in free software.

Question 15: Do you agree that a business should have the flexibility to reflect reliefs and allowances when it chooses?

Particular cases

Loss Relief

4.35. Where a business has established a loss for tax purposes, HMRC will retain this information. MTD provides the opportunity for HMRC to present this information in the business's digital tax account and record keeping software. In turn, this would enable the software to present a business with the options available to it such as how it can use the loss.

Personal allowance for individuals who have their own business

4.36. The personal allowance has the effect that a certain amount of an individual's adjusted net income is tax-free. It is available to all individuals and for the tax year 2016/2017 is set at £11,000. This amount reduces by £1 for every £2 of adjusted net income that is above £100,000. The effect of this is that the personal allowance is zero if an individual's income is above £122,000.

4.37. Individuals with income from employment or a pension would see the personal allowance set against this income. This is done by HMRC notifying the employer or pension provider of an individual's tax code. Individuals who have income from employment or a pension below their personal allowance, who also have earnings from self-employment, would currently use their remaining personal allowance to reduce their taxable self-employed income when completing their Self Assessment tax return.

4.38. HMRC would welcome views from the self-employed and landlords, including those who also have income from employment or a pension provider, on how they would wish to reflect the impact of their personal allowance within their software. Businesses could distribute this evenly across the tax year or include it as a deduction at the start of each year. Including the personal allowance in any of these ways will help provide the business with a more accurate picture of estimated tax position as the year goes by, and help them manage their cash flow.

Question 16: What do you consider is the most appropriate approach to reflecting the effect of the personal allowance on an individual's taxable business profit?

Partnerships

4.39. HMRC recognises that partnerships are involved in a diverse range of business activities, from the relatively straightforward, for example, a Bed & Breakfast run by a married couple in partnership to the more complex business (such as a large investment fund). This chapter does not explore the detailed issues faced by larger and more complex partnerships. Instead, it focuses on the overarching principles that will apply to all partnerships when calculating and allocating the taxable partnership profit.

4.40. HMRC considers that MTD offers the opportunity to sweep away a whole tier of the current process. Through a nominated partner, partnerships will fulfil the obligations of MTD, namely maintaining digital records and providing regular updates on behalf of all the partners.

4.41. The partnership's regular updates would feed directly into each partners' digital tax account as prepopulated, estimated income. Each partner's estimated income would be based on the profit allocation as reported to HMRC. As a result, each partner will not have to acquire software, maintain their own digital records or regularly update HMRC, unless they have other business interests.

4.42. This would mean that each partner is able to benefit from a cumulative in-year picture of the estimated Income Tax and NICs position and remove the need to complete a partnership page, as part of wider moves to end the tax return, as shown in the example below.

Fig 4.2. Partnerships, MTD software and digital tax accounts

'The Lunch Box' is a sandwich bar offering a range of lunchtime and afternoon snacks. Sylvia, Janet and Donna run the business as a partnership, with Sylvia as the nominated partner. The three partners have agreed through the partnership agreement to share profits 40:30:30.

Sylvia, as nominated partner, updates the business MTD software for quarter one with the partnership's estimated taxable profit of £15,000. This pre-populates each partner's digital tax account with estimated income. When they log into their own digital tax accounts, Sylvia can see her estimated share is £6,000, Janet can see her estimated share is £4,500 and Donna can see her estimated share is £4,500.

They know that this will be updated throughout the year and helps remove the surprise of their annual tax bill.

Question 17: Is this the right treatment of partnerships? Are there any additional partnership issues that need to be considered?

Income from property let jointly

4.43. HMRC recognises that for individuals who receive income from property let jointly we need to explore the interaction between their software, HMRC's systems and the individual's digital tax account.

4.44. Currently, each individual would provide their own Income Tax return, detailing their share of the rental income and allowable expenses. HMRC believes that there is potential to adopt a similar approach to that described for partnerships.

4.45. HMRC's proposal is that one of the landlords would be the 'nominated individual'. The nominated individual would fulfil the obligations of MTD, namely maintaining digital records and providing regular updates, on behalf of all the individuals who had an interest in the property.

4.46. The regular updates would automatically feed the estimated amounts into each individual's digital tax account. This means that they would benefit from having a clear view of their estimated in-year Income Tax and NICs position.

Question 18: Is this the right treatment of individuals who receive income from property, let jointly?

Construction Industry Scheme

4.47. HMRC recognises that for members of the Construction Industry Scheme (CIS) there is a need to explore the interaction between a contractor's software, HMRC's systems and an unincorporated subcontractor's software.

4.48. Currently, a contractor deducts money from a subcontractor's payments, advising HMRC before paying over these deductions.

4.49. An unincorporated subcontractor currently completes a Self Assessment tax return; this would include the details of any deductions made under CIS, with any additional liability or refund being calculated.

4.50. HMRC proposes that a contractor's CIS returns will feed directly into a subcontractor's digital tax account, detailing the total gross payment and any tax withheld. This would mean that subcontractors would only need to check that this information was accurate, allowing them to focus instead on keeping records relating to any additional income or expenditure.

Question 19: Is this the right treatment of subcontractors within the Construction Industry Scheme? Are there any other CIS issues that need to be considered?

5. Providing HMRC with Updates

5.1. This chapter considers how businesses, the self-employed and landlords will provide HMRC with regular updates under Making Tax Digital (MTD). In particular, it considers the level of detail the updates must contain, the time periods the updates cover and when they should be submitted.

5.2. Updating HMRC quarterly and more frequently if the business desires will ensure the tax system operates on a 'near real time' basis, giving businesses more certainty over their tax bill and keep their tax affairs much more up to date. Once a business's software has compiled the relevant data, they will feed it – via the updates – directly into HMRC systems, eliminating the distinct step of transposing data from their accounting records to a separate tax filing product. For many businesses, updating HMRC in this way will be light-touch and more easily integrated into day to day business activity.

Updates – the process

5.3. Lots of businesses are already updating HMRC at least as frequently as MTD will require. Two million businesses send their VAT submissions either monthly or quarterly and all businesses with employees already report PAYE information monthly through the Real Time Information process.

5.4. We have listened to business concerns about updating transaction level data to HMRC and therefore confirm that the update of income and expenditure will be only summary data. HMRC systems (including businesses' digital tax accounts) will only be updated when businesses provide an update. HMRC will provide for common software formats and categories and for data to be automatically tagged by software.

5.5. The updates to HMRC, provided quarterly or more often if the business prefers, will include the changes since the previous update. The business will also be able to change any indicators, for example to report a new source of property income.

5.6. As a business will have recorded and categorised transactions once only in the software, the application will be able to calculate the profit or loss for Income Tax and NICs purposes as well as any VAT position (if VAT registered) and easily update HMRC for both purposes. Under this approach, new businesses would be required to make their first update up to four months after the date that the business first became active.

5.7. The actual update process should be a simple data upload to HMRC, and because the work of categorising transactions has already been done it should be no more work to upload detailed updates than it will be to provide updates with only a small number of changes since the last upload.

5.8. The other data entries needed to reach an estimate of Income Tax and NICs payable, such as reliefs, allowances and tax adjustments would also form part of the data update to HMRC.

Fig 5.1 Updating HMRC

Judith receives a notification each quarter that reminds her when a quarterly update is due. This prompts her to access her software, which she can do at a time that best suits her.

After checking the amounts for the last quarter she is easily and quickly reassured that the correct amounts are included and categorised appropriately. She is happy to confirm the update within her software and at the touch of a button HMRC is updated. Her estimated tax for the year to date is then presented and she receives a notification that her update has been received, giving her confidence her tax affairs are up to date.

5.9. HMRC will use the data in the updates to build a better understanding of each business. This data provision will help HMRC provide support and assistance to those businesses who need it. In turn this enables HMRC to more easily identify those businesses who deliberately do not comply with their tax obligations and to focus its efforts on them. Over time, compliant businesses will see benefits from a reduction in unnecessary HMRC interventions.

Updates – level of detail

5.10. Businesses over the VAT threshold already complete Self Assessment tax returns detailing and categorising their income and expenditure. But they currently submit less detailed VAT returns. Under MTD, quarterly updates will cover both taxes and one option might be for the dataset for each update to be standardised, for example, on the Income Tax return model mentioned in Chapter 3 and an example of which is shown in Annex A. Examples of such transaction categories could include totals for advertising, stationery, travel and subsistence, and so on. Although this is more detail than is currently provided for VAT returns, because businesses already have to categorise their transactions for Income Tax, this should not represent any extra work.

5.11. The software could therefore use a single transaction record for both Income Tax and VAT purposes and also use this to generate the summary level data needed for each update. Non-VAT registered businesses (and landlords) will submit a categorised income and expenses update with any optional allowances as detailed in Chapter 4.

5.12. VAT registered businesses will submit an update that is also a VAT return - the VAT return element will require an additional declaration. Businesses that are currently required to submit EC or Reverse Charge sales lists could, if still required to in the future, submit these as part of the update rather than, as now, via a separate HMRC online service; this would depend on software functionality.

5.13. The update for VAT registered businesses could include additional VAT data – this could be summary totals split by different VAT rates, as well as the detail that is currently required to be calculated in the VAT account. The VAT account contains summary totals of the VAT liability and details of various corrections and adjustments to the VAT due – further detail on what is in the VAT account is available in VAT Notice 700 on GOV.UK.

5.14. For those businesses that operate them, there is the potential to include in the updates, data and calculations relating to a variety of special VAT schemes, for example, retail schemes, margin schemes etc. The advantage of this for businesses is that errors would be spotted and corrected earlier, helping businesses operate these schemes correctly. Chapter 8 discusses potential impacts on businesses of providing regular updates to HMRC using digital tools. We would welcome views on whether, and if so, which VAT scheme data should be included in the updates.

5.15. For businesses below the VAT threshold the Self Assessment "three line account" is currently available as an easy way of giving condensed information to HMRC about business income and expenses, although it cannot be used for certain income types. Another option, therefore, might be to retain this in some form, although perhaps only for the very smallest businesses.

5.16. Use of the three line account to update HMRC does not affect the record-keeping requirements on businesses which are still required to keep invoices, receipts and records. The mandatory use of software to capture transactions will also facilitate their categorisation. Given that this work is done anyway to calculate an accurate tax liability, providing the update to HMRC with the additional detail would represent no additional work for the business.

Question 20: Do you have views on how detailed the summary data in the updates should be, and whether the level of summary data should be different depending on the size of the business?

Question 21: Do you have any comments on the categorisation of summary data in the updates?

Question 22: Do you have any views on what VAT data the updates should contain? Do you have any views on the advantages or disadvantages of including VAT scheme data in the updates? If so, which schemes and which data should be included in the updates?

Updates – time periods and time limits

5.17. The periodic updates of summary data to HMRC will be made quarterly but could be made more frequently, if businesses choose to do so. So that businesses have a simple and easily understood obligation, HMRC expects that most businesses will want a straightforward cycle of submitting updates every three calendar months. VAT registered businesses who are currently required to submit monthly returns would continue on a monthly basis.

5.18. There will be flexibility to cover those updates at commencement or cessation of trading which do not correspond neatly with calendar months.

5.19. Some businesses, particularly those with seasonal trading patterns, which are not VAT registered, may want more flexibility around completing their update cycle. This could mean that as long as the maximum period between updates is three months, there would be no fixed update cycle – although the trade-off for this could be that a business makes more than four updates in a year.

Question 23: What flexibility around update cycles would be useful?

5.20. When their update is due, businesses will have time to compile this and declare that that period's data is complete to the best of their knowledge (taking into account the flexibility around tax and accounting adjustments described in Chapter 4). The business will receive reminders via their software that the update is due. The process of updating should be as simple as connecting to HMRC systems and pressing a button to upload the data.

5.21. A standard time limit for uploading updates across all taxes would be straightforward and easily understood. At present the VAT return requirement for VAT registered business making returns quarterly is one month and seven days after the quarter end. HMRC proposes to standardise the time limit for businesses to upload their updates at one month following the end of each update cycle. It does not follow that the due date for payment of VAT will necessarily change as a result; consideration of VAT payment dates is outside the scope of this consultation.

Question 24: Do you agree businesses should be allowed one month to submit their update? Would any problems be caused for VAT registered businesses by standardising the time limit for updates for all taxes?

Updates – ensuring good compliance

5.22. In addition to the software guidance, mentioned above, businesses could receive prompts and nudges from HMRC at the point at which they compile their updates. These prompts and nudges could identify for the business possible problems with the update, or other unusual features of the data, helping them get their tax affairs right and avoid storing up possible problems. Businesses will have the option of revising or correcting any problems identified before they finalise their update and upload this.

5.23. This kind of assurance will be available every time a business updates HMRC, increasing the accuracy of their tax affairs over time and reducing the burden otherwise associated with HMRC checks into an annual tax return. In time, this will enable HMRC to focus its resources more effectively, target the non-compliant and reduce the burden of compliance checks on compliant businesses.

5.24. To ensure good compliance, HMRC proposes to maintain its existing level of compliance powers, which will provide certainty and familiarity to businesses as they adapt to the new MTD requirements. The areas of the compliance framework for which legislative changes may be required are covered in a separate consultation document, Making Tax Digital: Tax administration published today alongside this consultation. That consultation also includes more detailed proposals for sanctions to support the new obligation to make regular updates. HMRC has listened to businesses' concerns about making unintentional mistakes as they become accustomed to new digital reporting obligations and an unfamiliar way of interacting with HMRC, so we will let the new process settle before any new sanctions regime takes effect.

Updates – cumulative picture

5.25. Over time, the updates, combined with tax and accounting adjustments and data from the digital tax account will build an increasingly accurate picture of a business's tax position. Summaries of income and expenses will be shown as cumulative totals and – optionally - combined with allowances and reliefs so businesses can obtain 'near real time' estimates giving them greater certainty and allowing better tax payment forecasting.

5.26. People with employment or pension income and who have a secondary source of income from self-employment or property below £10,000 are covered by the exemption announced at Autumn Statement 2015. (Chapter 7 discusses this exemption in more detail.) For all other businesses, any employment or pension income they have could be reflected in the digital tax account or through the business software package, so they would have a complete picture of all their tax affairs. How exactly this picture is displayed would be decided by the software developers, in accordance with market demand.

Fig 5.2. Updating

Richard's period of account is 12 months in length and ends on 31st December. Throughout the year he has maintained the electronic records of his income and expenses, categorising these as he goes. The table on the next page outlines a summary of the information he has recorded in his software:

Quarter	Total Income	Total Allowance Expenses	Quarterly Net Profit	Reliefs & Allowances	Quarterly taxable profit	Cumulative taxable profit
1 January 2019 – 31 March 2019	£9,000	£2,500	£6,500	£0	£6,500	£6,500
1 April 2019 – 30 June 2019	£10,000	£1000	£9,000	£5000	£4,000	£10,500
1 July 2019 – 30 September 2019	£6,500	£1,500	£5,000	£0	£5,000	£15,500
1 October 2019 – 31 December 2019	£5,250	£1,250	£4,000	£0	£4,000	£19,500

The software also summarises Richard's VAT position:

Quarter	VAT due on sales	VAT reclaimed on purchases	Net VAT due
1 January 2019 – 31 March 2019	£1,800	£453	£1,347
1 April 2019 – 30 June 2019	£2,000	£191	£1,809
1 July 2019 – 30 September 2019	£1,300	£269	£1,031
1 October 2019 – 31 December 2019	£1,050	£241	£809

Having maintained electronic records and provided regular updates to HMRC, Richard can see throughout the year, a cumulative overview of his tax position. This has helped him budget and removes the surprise of his annual tax bill:

Quarter	Estimated Income Tax	Estimated Class 4 NICs	VAT due	Total	Payments	Estimated Outstanding
1 January 2019 – 31 March 2019	£1,300	£0	£1,347	£2,647	£1347	£1,300
1 April 2019 – 30 June 2019	£2,100	£219.60	£1,809	£4128,60	£1809	£2319.60
1 July 2019 – 30 September 2019	£3,100	£669.60	£1,031	£4,800.60	£1031	£3769.60
1 October 2019 – 31 December 2019	£3,900	£1029.60	£809	£5738.60	£809	£4929.60

Starting to update HMRC

5.27. Businesses will begin to fall within the requirement to keep digital records and make regular updates for Income Tax and NICs purposes from April 2018. Chapter 7 discusses the possibility of deferring the start date by up to 12 months for the smallest unincorporated businesses within scope. But it will be essential for all businesses to have a clear understanding of the date from which their obligations commence.

5.28. There are various options on which to base the start date of a business's obligation to update HMRC. The previous year's accounting date and the start of a business's new period of account could provide a convenient reference point from which to begin keeping digital records and the new method of updating HMRC. This may require some rules that would disregard changes to accounting dates for MTD transition purposes. For the avoidance of doubt, however, the point at which a business starts to provide updates would not alter the Income Tax year in which the income arising in relation to a period of account is taxable.

5.29. Option 1 would be for businesses' update cycle to begin on the first day after their first accounting date that follows 5 April 2018. This is straightforward for most businesses to understand and aligns updates with their period of account. A business whose first accounting date after 5 April was 31 August 2018 would therefore begin updating on 1 September 2018, the first day of their new period of account. Their first quarterly update would therefore cover September, October and November 2018, their second would cover the quarter from December 2018 through February 2019 and so on.

5.30. In the above example, information relating to periods of account up to and including 31 August 2018 would need to be included in a Self Assessment tax return, as now. If the business then chooses to end its next period of account before 6 April 2019, then the taxable profit for that next period would also need to be included in a tax return for the year 2018/19. However, for periods of account that fall to be taxed in the 2019/20 tax year onwards, a Self Assessment tax return would no longer be required in relation to the profits of those periods.

5.31. A business whose accounting year was fully aligned with the tax year and whose accounting date falls on 5 April, would start updating from 6 April. Their first update period would then end no later than 5 July and so on. One advantage of this option is that none of the approximately 2.5 million businesses whose Income Tax year aligns with their period of account would need to complete a Self Assessment tax return for the tax year 2018/19.

5.32. A variant on Option 1 would aim to regularise the position of businesses who choose a 6 April start date for their period of account so that their update periods end on a calendar month end. For a 6 April start date their first MTD update covers the period until the end of June. Their subsequent update periods would then run to the end of September and December, with their final update covering the period from 1 January to 5 April.

5.33. There is a case that updates covering calendar month periods are easy to remember and, as the deadline for providing an update would then also fall at the end of a calendar month, this may give small businesses, in particular, clarity on when they need to fulfil their obligations.

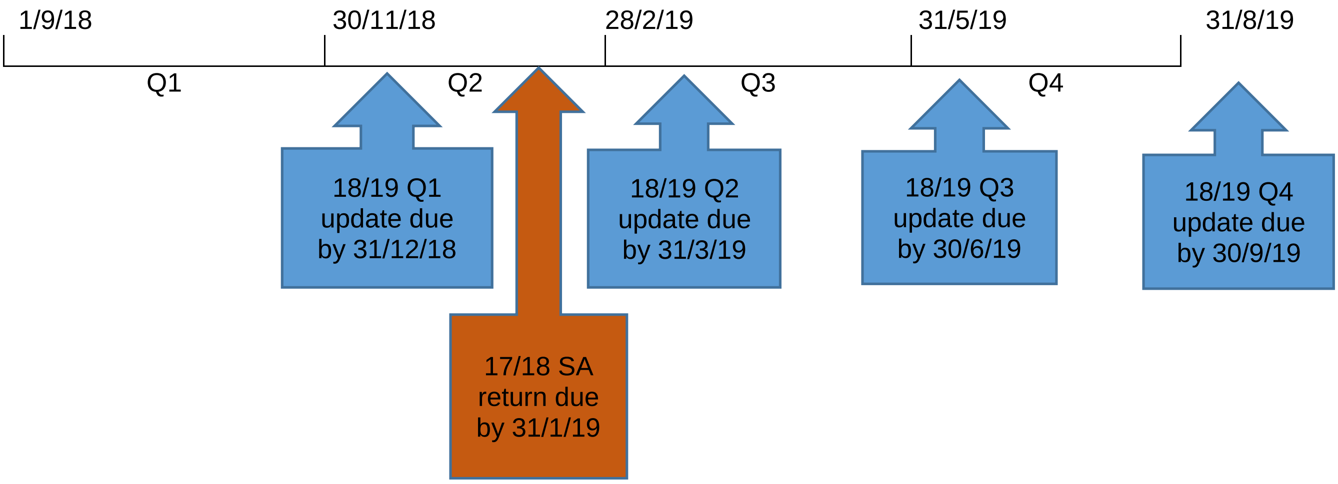
5.34. Existing rules whereby businesses with year ends ranging from 31 March to 4 April can all be treated as equivalent to accounts prepared to 5 April unless the business elects otherwise could be continued for the purposes of MTD. This avoids the need to apportion profits for the short period of up to five days.

Fig 5.3 Option 1: Transition from tax return to updating

Eve's accounting date is 31 August so her period of account runs from 1 September to 31 August. Her Self Assessment tax return for the financial year 2016/17 will therefore be due before 31 January 2018, while her SA return for the year 2017/18 will be due before 31 January 2019. These SA returns will be submitted using his digital tax account.

With MTD introduced from 6 April 2018, Eve enters MTD on 1 September 2018, the start of her 2018/19 period of account. Assuming she does not update more frequently, her first quarter runs from 1 September to 30 November 2018 with the update due one month after the quarter ends, or 31 December 2018. Eve would be reminded of her forthcoming update by her software.

Eve's period of account 2018/19:



5.35. It is clear that, where a business draws up accounts annually but on a date shortly before the start of the new tax year in April, under Option 1 above they would transition into MTD last of all. An alternative transition option (Option 2) could be to bring businesses into the update process sooner. This would still base the start of a business's update cycle on their accounting date. The chosen accounting date could define their update cycle. So a business drawing up accounts annually with a 28 February accounting date, and providing updates quarterly, would have update periods that end in May, August, November and February. Under this option businesses with a 28 February accounting date would not wait until 1 March 2019 to begin providing updates. Instead, their first update would relate to the period from 1 June 2018 to 31 August 2018.

5.36. Option 2 would have the effect of bringing all unincorporated businesses into the update process quickly. On the other hand, it would mean more businesses would need to include information provided as part of the update process in their final Self Assessment tax return. So, in the example in the preceding paragraph, the updates provided from 1 June until the accounting date of 28 February would still need to be reflected in a tax return for the tax year 2018/19. In other words, this would not mean the business is taken out of Self Assessment any earlier.

5.37. For unincorporated businesses that are also VAT registered, there are additional considerations that need to be made. VAT businesses will be completing MTD updates for Income Tax purposes from 6 April 2018 but VAT only comes into the scope of MTD on 6 April 2019, so for this first year a separate VAT return will be required. One way of easing the transition to updates covering both Income Tax and VAT, would be to align the initial MTD updates on a business's quarterly VAT cycle.

5.38. Option 3, therefore, would be for VAT registered businesses on quarterly cycles to begin updating in line with their quarterly VAT cycle for their first full quarter from 6 April 2018. They would then make a separate update for MTD in addition to their VAT return – but on the same quarterly cycle – until VAT comes into the scope of MTD in April 2019. They would then complete a single, aligned update for direct and indirect tax purposes. However this cycle would only align with a business's period of account if it has previously chosen to align its period of account with its quarterly VAT cycle. If a business hadn't chosen to align its VAT cycle with its period of account, then in similar fashion to Option Two above, the information included in updates provided up until the accounting date would still need to be reflected in a Self Assessment return.

5.39. HMRC considers that for most businesses, Option 1 provides the simplest method of transitioning into MTD, and Option 1B provides the greatest clarity for businesses on their regular obligation to complete an update. But we would welcome views on this and on the alternatives set out. For VAT registered businesses, Option 3 has the advantage of aligning direct and indirect tax updates, many of which will already have aligned their VAT quarters with their period of account.

Question 25: What method of deriving a business's start date for providing updates under Making Tax Digital would be most straightforward for businesses?

Alignment of updates

5.40. Businesses have and will retain complete flexibility over their VAT declaration cycle and their choice of accounting dates, so will be able to align existing VAT returns with their direct tax updates if they so wish. When VAT comes into the scope of MTD after April 2019 their update will cover both direct tax and VAT and they need not submit separate updates on different cycles.

5.41. Businesses who use the VAT Annual Accounting scheme will complete updates quarterly with profits tax data, but still complete only one VAT declaration per year.

5.42. As part of the Chancellor's commitment to simplify income tax for businesses, a separate consultation Simplifying tax for unincorporated businesses is considering reforms to basis periods, which will simplify computational rules, remove overlap taxation when self-employed sole traders start up in business or change their accounting dates, and provide flexibility to businesses that want their accounting date to fit with other reporting obligations and individual preferences.

5.43. Because of the way the basis period rules work, even with basis period reform there will be a cohort of customers experiencing overlap taxation, completing Self Assessment tax returns while also completing MTD updates. These will be customers who commence trading from 2017 onwards until MTD commencement, but they will be a small and declining population.

Amendments to records or previous updates

5.44. So long as a customer routinely records all of their transactions in their software, then the software should provide an accurate picture to the customer of their taxable income and allowable expenses for an update period. However, it is always possible that after an update is submitted, the customer will identify an error, e.g. an omitted transaction, or need to make a change to a previously captured item of information. Moreover, as noted in Chapter 4, HMRC proposes that businesses keeping accounts on an accruals basis will have considerable flexibility as to when they make certain accounting adjustments that affect their taxable profit.

5.45. The next few paragraphs of this chapter consider amendments to previously captured information that has been provided to HMRC via an update.

5.46. HMRC considers it is important that the software used by the customer is able to record that a figure has been amended, at least after an update has been made. If data in the software can simply be overwritten then the customer may have no audit trail of in-year amendments made.

5.47. It will be useful for the customer to be able to view the history of changes made between one update to HMRC and another that relate to the same period of account.

5.48. Chapter 6 considers how businesses might finalise their taxable profit for a period of account. For profits taxes, as long as the tax position for period of account is still to be finalised, a business can make an amendment at any time it chooses. However, HMRC considers that corrections to errors identified by the customer after an update is made should be notified by that customer as soon as possible.

5.49. For profits taxes, updates will operate cumulatively, meaning any amendment to an error reported in, say, the first regular update for a period of account, and corrected prior to the next regular update, will change the cumulative profit or loss position for the whole of that period to date.

5.50. Nonetheless, the amendment will very likely be captured in the software as a change to the data relating to a transaction that occurred in the period covered by the first regular update. This is different to the current process for VAT amendments.

Question 26: Do you wish to make any comments about the operation of 'in-year' amendments to updates for the purposes of profits taxes or VAT?

6. 'End of Year' Activity

6.1. The charge to tax on business profits, whether the business is unincorporated or is a company, arises on the profits for a period of account. This period could be any length. This chapter explores the potential approaches to how businesses might finalise their taxable profit for a period, including the activity they may need to undertake and how long they should have to do so. For ease, throughout this chapter we refer to any such activity that a business undertakes, having previously supplied regular updates to HMRC, as 'End of Year' activity.

6.2. The process described in this chapter is relevant only to profits-based taxes. Any existing VAT processes that businesses perform at the end of a year (or the end of an accounting period, if earlier) will remain unchanged.

An overview of the process

6.3. Throughout the year, businesses will have provided HMRC with regular updates, building a picture of their tax position. This will mean they will not need to spend time and effort at the end of each year gathering details of expenditure and income, trying to recall events from a year earlier. For the million or so businesses using the cash basis of accounting, the process for finalising their tax position will be as simple as confirming their updates are complete, then making a declaration that everything is complete and correct to the best of their knowledge. That declaration – assuming the individual liable to tax on the business income has no other income to declare – will then crystallise their income tax liability for the year.

6.4. However, we recognise that some businesses will still need the opportunity to review the information they have previously provided, make any necessary accounting adjustments or claim any reliefs and allowances that they have not included in their regular updates. Where businesses have previously included accounting adjustments, they will need to consider whether these are still correct or whether further adjustments are needed. Having made all final adjustments and made claims to reliefs or allowances to arrive at a business profit or loss for the period, these businesses will also make a declaration that everything is complete and correct as regards their business.

6.5. We do not envisage that the activity required at End of Year will be greater than that which businesses currently undertake to complete their Self Assessment tax return. We do however recognise that business will have also provided us with regular updates. Chapter 8 explores in detail the impacts on businesses of Making Tax Digital (MTD).

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How long businesses will need to complete the process

6.6. Having considered what businesses will need to do to finalise their regular updates, we now wish to understand how long a business needs to do so.

6.7. Chapter 5 proposes that a business should provide their regular updates no later than one month after the end of an update cycle.

6.8. HMRC has considered whether businesses should carry out their End of Year activity at the same time as providing their final in-year update i.e. within one month of their accounting date. This would help businesses swiftly conclude their tax affairs and give them early certainty of their tax position.

6.9. However, we do not believe that it would be reasonable to ask businesses to do this. We know that businesses, and their agents, value the opportunity that the current tax system affords them to include seeking advice on which adjustments are necessary. Whilst MTD will offer businesses the opportunity to reflect these adjustments in-year, businesses still want the opportunity to consider which are necessary or seek professional advice.

6.10. A variant of the above would be to allow businesses more time (i.e. longer than one month) to provide their final in-year update so that they do this at the same time as they complete their End of Year activity.

6.11. However, HMRC considers that it would be more helpful to have distinct processes and deadlines for each activity a business needs to undertake. Changing the deadline for the provision of the final in-year update could create confusion as well as placing an unintended significance on the last update for any period of account.

6.12. HMRC therefore considers that any End of Year activity undertaken should be a standalone process from the provision of regular updates. This ensures businesses continue to have the opportunity to consider fully their End of Year position, seeking professional advice where they so choose.

Question 27: Do you agree that the process of finalising the regular updates should be separate to the regular updates?

6.13. Whilst businesses will have flexibility as to when they carry out the End of Year activity, we now need to consider how long it is appropriate to allow.

6.14. HMRC recognises that each business is different and that many will have their own reasons for choosing exactly when they currently file their return. However, wherever possible, HMRC is keen to ensure that businesses are treated consistently. Therefore, whilst this consultation focuses on unincorporated business, it may be helpful to outline the different timescales companies and unincorporated business currently have to file a tax return.

6.15. Unincorporated businesses, including the self-employed and landlords, are required to file their Self Assessment tax return by 31 January following the end of the relevant tax year, although they are required to provide this sooner if they are not filing online.

6.16. Incorporated businesses are required to file their company tax return usually 12 months after the end of their period of account, with a requirement to pay Corporation Tax, usually nine months and a day after the end of their period of account. HMRC understands that the effect of the nine-month timeframe for payment means that, in practice, some businesses file their tax return at the same time.

6.17. Given that incorporated businesses will typically have more complicated affairs, HMRC's preferred approach is that all businesses should have nine months, from the end of their period of account, to complete their End of Year activity.

6.18. Of course not all business will need this time. As noted above, the more than a million businesses that use the cash basis of accounting for income tax purposes will find the End of Year activity easy. As a result, many will be able to, and may want to, complete their End of Year activity at the same time as providing their final regular update.

Fig 6.1. Cash basis End of Year

Judith uses the cash basis to account for Income Tax. Her period of account matches the tax year exactly and she has chosen to update HMRC quarterly throughout the year. This has helped give her an overview of her estimated tax and NICs position.

During Quarter 3, she purchased a car that she uses to take the children out on day trips, but she also has private use. She had included in Quarter 3 the effect of a claim to capital allowances.

At the same time as providing her final quarterly update, she decides to carry out the End of Year activity. Her software prompts her to consider whether all her previous updates are accurate and tells her that she needs to claim the capital allowances she indicated might be claimed in her update for Quarter 3. Judith checks that there is nothing else she needs to tell HMRC about and confirms everything is complete and correct (in the process making the capital allowances claim formally). This crystallises Judith's taxable profit and she can see that the updates she provided through the year are reflected in this and in her Income Tax and National Insurance liability.

6.19. Many businesses rely on the services of an agent to file their Income Tax return and will continue to do so following the introduction of MTD.

6.20. The nine month window proposed for businesses to undertake their End of Year activity should allow sufficient time to consult an agent. It will also help mitigate the current work peak faced by agents at the end of January that the current fixed deadline for Self Assessment tax returns causes.

Fig 6.2. Cash basis End of Year with agent advice

Dimitri is a self-employed mechanic. He uses the cash basis to account for Income Tax and has been updating HMRC regularly throughout his period of account. This has helped give him an overview of his estimated Income Tax and NICs position.

After providing his Quarter 4 update, Dimitri is prompted to complete his End of Year activity as well. However, Dimitri has always used his agent, Sarah, to file his Income Tax return in the past and would feel more comfortable still doing so. He has already given Sarah access to his software and sends a secure message her, asking her to complete the End of Year activity.

Sarah knows that under MTD she has up to 9 months from the end of Dimitri's period of account to complete this. She has a number of competing priorities; she assures Dimitri that she will get this done and that he will be automatically notified when she does. She can access Dimitri's software, including all his records and regular updates. This means the End of Year activity required is easier than before as she can focus on the more complex accounting and tax adjustments required.

She completes Dimitri's End of Year activity within 3 months. This is automatically acknowledged and she can now see that Dimitri's taxable profit has been crystallised, confirming his Income Tax and National Insurance liability.

6.21. Other businesses, that do not use an agent, will be able to find help and support on what they need to do to complete their End of Year activity:

Fig 6.3 Accruals basis End of Year

Eve uses the accruals basis to account for Income Tax and has been updating HMRC regularly throughout this period of account. This has helped to give her an overview of her estimated tax and NICs position.

Having provided her fourth quarterly update, the software prompts Eve to complete any additional End of Year activity within 9 months of her period of account end date. As Eve has chosen not to include any stock accounting adjustments in her regular updates, she knows she now needs to reflect these. Using the help and support available through her software, Eve reviews the stock that she holds at the end of her period of account. She records the necessary adjustments. Once she has completed her End of Year activity, her Income Tax and NICs estimates are updated. As she has no other income to declare, once she submits this information to HMRC with a declaration, her tax and NICs liability is crystallised.

Eve can see that the End of Year figure for Income Tax and NICs is not the same as her estimated position in-year. However, she knew that this would be the case as the software explained this when she decided not to include the necessary accounting adjustments to reflect her stock in her regular updates. Eve still found it helpful having an estimate of her tax and NICs position as it removed the fear of an unknown tax bill arriving many months after the end of her period of account.

Question 28: Do you agree that businesses should have nine months to complete any End of Year activity?

Amendments after the End of Year process has been completed

6.22. There may be instances where businesses need to amend their tax position after the End of Year activity has been completed and a declaration made that everything is complete and correct. Typically, this is due to additional or new information. Occasionally, business may also need to correct an error.

6.23. HMRC will ensure that, as is already the case with tax returns, business have the facility to make such amendments. We will consult separately at a later date on the process and time limits for this.

7. Exemptions

7.1. At Autumn Statement 2015, the government announced that these new processes would apply to most businesses, self-employed people and landlords. It also announced a limited exemption for individuals in employment or pensioners with secondary incomes of less than £10,000 per year from self-employment or property.

7.2. We have responded to feedback that the exemptions set out at Autumn Statement did not go far enough. This consultation therefore confirms that all unincorporated businesses and landlords with annual incomes below £10,000 will be entirely exempted from the new obligations. It also proposes to defer implementation for a limited group of businesses and landlords with annual incomes above that threshold. We are consulting on the appropriate income threshold for exemption and on how eligibility for deferral should be defined.

7.3. We are taking a common sense approach to implementing these reforms. We will not force those who cannot use software and apps to meet the requirements of MTD; and have exempted them entirely from the new obligations. We have also set out further exemptions for charities and community amateur sports clubs.

7.4. In addition to these exemptions, we have provided an opportunity for other groups to make the case for why they should be out of scope. We will work with businesses to identify any practical difficulties which would prevent MTD working for their particular sectors and consider further exemptions for those sectors where appropriate.

How exemptions will work

7.5. MTD will be the default method by which businesses manage their tax affairs. All businesses with Income Tax, National Insurance, VAT or Corporation Tax obligations will be within scope of these requirements unless they have been explicitly exempted.

7.6. The requirements will apply to almost all business types including (but not limited to) the self-employed, landlords, public and private companies, partnerships, limited liability partnerships, collective investment schemes and Lloyds of London members. All exempted businesses will be able to voluntarily update HMRC using software or apps, should they choose to do so.

Criteria for exempting businesses

7.7. There are a large number of different business types, many of which have bespoke tax processes or rules. We know that the requirements of MTD may not work for all these businesses. Therefore, HMRC would like to use this consultation to gather views on whether any additional business types should be exempted from these requirements.

7.8. There may be particular characteristics of a business type for which the requirements of MTD will not be suitable. We are keen to receive submissions from stakeholders on what these characteristics might be. They might include, but are not limited to, not routinely filing a company tax return or Income Tax Self Assessment return each year, a lack of benefit to the particular business type from the MTD platform or lack of available software for a particular niche business.

Question 29: What criteria should be applied in determining whether to exempt a particular business or business type from the requirements of MTD?

Charities

7.9. This section considers whether charities should be exempted from the requirements of MTD. The vast majority of charities do not incur a direct tax liability on an annual basis. Charities would usually only submit a company tax return or Income Tax Self Assessment return if they had spent some of their income on non-charitable activities or where they had received a notice to file a return from HMRC. However, many charities do interact with HMRC on a quarterly basis where they are VAT registered.

7.10. We believe that there are significant potential benefits for charities in maintaining digital records and in using software to update their digital tax account where they do need to make a return for Corporation Tax or Income Tax Self Assessment. However, HMRC considers that due to their unique tax status and for the reasons set out above, charities should be exempted from the digital update requirements. Instead, it will be a voluntary process.

7.11. We are also consulting on whether charity trading subsidiaries should be exempted from the requirements of MTD. We recognise the unique status of charities and their need to maintain a consistent approach in managing their tax affairs across their different operational areas. However, we also recognise the need for a level playing field where charity trading subsidiaries are competing with other non-charity affiliated businesses. We are keen to receive submissions on whether this group should also be exempted.

Question 30: Should charities be exempt from the requirements to maintain digital records and to update HMRC at least quarterly?

Question 31: Should trading subsidiaries of charities be exempt from the requirement to maintain digital records and to update HMRC at least quarterly?

Community Amateur Sports Clubs

7.12. Like charities, Community Amateur Sports Clubs (CASCs) enjoy special tax status. CASCs sit within the Corporation Tax regime and enjoy many similar tax reliefs. Also like charities, most CASCs do not complete an annual company tax return.

7.13. Like charities, this group has particular reliefs, which mean they do not usually need to file annual returns for their profit-based taxes. We believe that the MTD requirements would not be appropriate for this group, given their particular tax arrangements.

7.14. Again, HMRC believes there are significant potential benefits for CASCs in maintaining digital records and providing regular updates where they do need to make a company tax return. However, we consider that due to their unique tax status and for the reasons set out above, CASCs should also be exempted from the requirements of MTD.

Question 32: Should CASCs be exempt from the requirement to maintain digital records and to update HMRC at least quarterly?

Insolvent businesses and Insolvency Practitioners

7.15. Insolvent businesses (including insolvent self-employed individuals) and those insolvency practitioners managing their affairs under the insolvency rules are currently exempted from the Corporation Tax and VAT online filing requirements. They are not exempted from the online filing requirements related to PAYE, when payments are made to employees in lieu of wages. HMRC still receives large volumes of paper returns from insolvency practitioners, creating extra work and bureaucracy for both the insolvency industry and HMRC.

7.16. The move by HMRC to a tax system which is fully digitised by 2020, means withdrawing some of our paper-based services and encouraging taxpayers and their representatives to interact digitally where that approach is fair and appropriate. We are therefore consulting here on whether businesses within the insolvency process should be included within scope of the requirements of MTD, in the same way as any other business.

7.17. This would allow HMRC to provide a much more streamlined service for insolvency practitioners and would ensure they secure the maximum benefits from MTD. However, we also recognise that there are particular arrangements attached to the insolvency industry that may require a bespoke approach. For example, when businesses go into insolvency, there can be practical difficulties for the insolvency practitioner in arranging access to the insolvent business's digital tax account. There may also be particular security issues around the digital "handshake" as data from the business's digital tax account is passed to the insolvency practitioner.

7.18. HMRC would therefore like to hear from insolvency practitioners on how these new processes should be implemented; and any potential difficulties which might exist if mandatory digital engagement is introduced for this group.

Question 33: Should businesses within the insolvency process be included within the scope of the requirement to maintain digital records and to update HMRC at least quarterly; and are any special arrangements required for this group?

Defining those who cannot engage digitally

7.19. We know that not everyone is ready or able to use digital services. People have a range of needs and we will continue to provide extra support for those who need help. In this section, we provide further details of our proposed approach for those taxpayers who, even with extra support, cannot interact with HMRC digitally.

7.20. There is no single definition of digital exclusion in UK tax legislation. The Corporation Tax, PAYE and VAT regimes each take different approaches in defining those who cannot engage digitally. They have separate legislation covering exemptions to their general requirement that businesses should file online. We want to simplify this area for all taxpayers and therefore propose that the relevant legislation should be consolidated and, where possible, aligned. This would mean a clear definition of those who are not required to engage digitally with HMRC on the basis that they are unable to do so.

7.21. In defining this group, we will build on the existing online filing exemption for VAT and aim to apply this across the other tax regimes. Under the existing VAT regime, two particular groups are exempted from the general requirement to file VAT returns online on the basis of their inability to do so:

- a person who the Commissioners are satisfied is a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications; and

- persons for whom online filing is not reasonably practicable for reasons of disability, age, remoteness of location, or any other reason.

7.22. HMRC would like to receive views on whether this approach would be appropriate in defining exemptions in other tax regimes where digital engagement is mandated.

7.23. Where possible we will also take a consistent approach across business types. But some business types may require a tailored approach. For example, we recognise the different context in relation to incorporated businesses. A company has its own separate legal identity, and particular obligations under the Companies Act. This may require a different approach, in comparison to unincorporated businesses.

Question 34: Which businesses should be included within a consistent definition of persons 'unable to engage digitally'?

Exempting those who cannot engage digitally

7.24. Those who cannot engage digitally are by definition unable to maintain digital records on a rolling basis through the year, even with support from a friend, family member, agent or HMRC. We propose that this group should be exempted entirely from the requirements of MTD. This group of customers would not be required to maintain digital records. They would also not be required to provide quarterly summary updates to HMRC (of the type described in Chapter 5) by alternative, non-digital means. But this exemption would not affect any existing requirements to make returns to HMRC for VAT purposes on a quarterly (or other) basis.

7.25. Existing mechanisms (such as tele-filing and home visits) which support digitally excluded customers in providing their tax information to HMRC would continue. There would be no increase to the frequency with which digitally excluded customers are required to interact with HMRC.

Fig 7.1. Exempting those who cannot engage digitally

Jas is a self-employed tutor offering maths and physics tuition. He already keeps good paper records and currently submits his annual Self Assessment return on paper.

He has impaired vision and severe rheumatoid arthritis which makes it painful for him to use a computer. He does not own or use a computer or smartphone and the rural area he lives in has very limited broadband coverage. He does not have a local support network to support him in fulfilling his tax obligations. It is not reasonably practicable for him to provide his data to HMRC using the processes described in this document.

Jas would be exempted from the new Making Tax Digital obligations on the basis that it is not reasonably practicable for him to update HMRC using digital tools.

7.26. The government is clear that the MTD reforms should not force digitally excluded customers to engage more frequently with HMRC than they do at present. Existing support mechanisms for digitally excluded customers will continue. Existing tax obligations would also continue.

Exempting all businesses with income below £10,000

7.27. At Autumn Statement 2015, the government announced that there would be a limited exemption for individuals in employment or pensioners with secondary incomes of less than £10,000 per year from self-employment or property. This consultation confirms that we are replacing that exemption with a wider and simpler approach. All unincorporated businesses, including the self-employed and landlords, with annual income (turnover) below a threshold - to be determined, but not less than £10,000 - will be exempted.

7.28. This will ensure that a much greater volume of small businesses and landlords are exempted from the new obligations. Simplifying the criteria will also ensure that businesses can much more easily understand whether the new obligations will apply to them.

7.29. The exemption will not apply where someone's income is through their own incorporated business; we also do not propose to apply this exemption to Limited Liability Partnerships or to general partnerships which have partners that are not individuals.

7.30. In determining whether annual income is above or below the exemption threshold, the calculation would be based on total annual income per year from all business income streams. Therefore, a person with multiple sources of income which are individually below the threshold could be within scope for the requirements of MTD if the total annual income from these sources was above the threshold.

7.31. We are consulting here on whether £10,000 is the right level to set the annual income threshold and on how the threshold should operate.

Fig 7.2. Examples of Exempted Groups (assuming a £10,000 threshold)

Exempted groups would include:

a) a self-employed builder earning £9,000/year;

b) a full-time retail employee earning £21,000/year in their day to day job, who received £6,000/year in gross income from their unincorporated business selling vintage clothes online;

c) a self-employed person earning £4,000/year in gross income from their unincorporated part-time cleaning business and £4,000/year in rental income; or

d) a retired person receiving £15,000/year from their pension who owned a second property, receiving £9,000/year in rental income.

But this exemption would **not** apply to:

a) a self-employed builder earning £13,000/year;

b) a full-time retail employee earning £21,000/year in their day to day job who owned a second property, receiving £11,000/year in rental income;

c) a full time retail employee earning £21,000/year in their day to day job who also received £7,000/year in gross income from their own incorporated vintage clothing business; or

d) a self-employed person earning £8,000/year in gross income from their part time cleaning business and £4,000/year in rental income.

Question 35: Do you agree that £10,000 annual income is an appropriate threshold for exempting businesses from Making Tax Digital? Do you have any other comments on how the exemption should operate?

Deferring MTD for the smallest businesses

7.32. The reforms set out in this document will start to apply for many businesses from 2018. But we have listened to feedback that some smaller businesses require more time to prepare for these changes. We have set out above how businesses with very low annual incomes will be entirely exempted from the new obligations. But the government is prepared to go further.

7.33. We propose to defer the introduction of these new obligations by one year for a limited group of businesses and landlords with annual income (turnover) above £10,000 but below a defined upper income threshold. We would welcome views on whether an annual income (turnover) threshold is the right way to identify these businesses and at what level this upper threshold should be set.

Question 36: Should the smallest unincorporated businesses that are not exempt have an extra year to prepare for Making Tax Digital? How should eligibility for this group be defined?

Determining eligibility for an exemption

7.34. This section considers how a new or existing business might determine whether they are exempted from the requirements of MTD. This covers both those exempted due to having a low annual turnover and those businesses which are exempted for other reasons.

7.35. For existing businesses already complying with the new obligations but for whom an exemption becomes applicable (for example, due to a change in their circumstances where they become unable to engage digitally), we will ensure that the process for opting out is quick and straightforward.

7.36. To opt out, businesses would need to inform HMRC of their change of circumstances and retain evidence demonstrating that they fitted within the exemption category. For those taxpayers whose circumstances change and who are unable to engage digitally, HMRC will provide non-digital routes by which they can opt out of the Making Tax Digital for Business obligations.

7.37. Business incomes will obviously vary over time and many business types will not know at the start of any period of account whether their business will be above or below the exemption threshold. Similar issues apply to determining whether a business is a particular exempted entity type, since some businesses will change from one entity type to another as they develop.

7.38. Our proposed approach will be based on three principles:

Fig 7.3. Principles for determining eligibility for an exemption

The principles for determining eligibility for an exemption are:

a) Previous financial results and behaviour should act as a guide to future financial results and behaviour. Therefore, if a business fits the criteria for exemption in one period of account, it should usually be exempted in the following period. Equally, if it is within scope of the requirements of MTD within one period of account, then it should normally remain within scope in the next period.

b) Where the low annual turnover exemption may apply, a new business should make an initial assessment of whether their gross business income in their first year is likely to exceed the threshold. Where relevant, this assessment will govern whether the income exemption will apply.

c) A business should never be disadvantaged for unexpectedly receiving gross income which takes it above the exemption threshold.

Question 37: Do you agree that the principles set out in Fig. 7.3 are the right ones to use in determining eligibility for an exemption? Are there any additional principles which should apply?

Further exemptions?

7.39. This document has outlined a range of proposed exemptions from the requirements of MTD. However, we know that there may be business types which we have not identified, for whom an exemption might be appropriate. We are therefore providing an open opportunity here for you to propose any further business types which should be exempted.

Question 38: Which additional groups (if any) should be exempt from the requirements to maintain digital records and to update HMRC at least quarterly?

8. Initial Assessment of Impacts

8.1. This chapter sets out HMRC's initial assessment of the impacts of the new Making Tax Digital (MTD) requirements for businesses to maintain digital records and provide regular updates to HMRC. This is based on our current understanding from early engagement and informal consultation with a wide range of stakeholders, including representative and professional bodies and businesses, and HMRC's initial research and analysis. This initial assessment does not address other MTD initiatives, the impacts of which are considered in other consultations.

8.2. The scope of MTD (Income Tax and National Insurance contributions obligations from April 2018, VAT from April 2019 and Corporation Tax obligations from April 2020) means that by 2020 most businesses, self-employed people and landlords will be required to use software or apps to keep their business records and to provide HMRC with regular updates of information. The business population within the scope of MTD is diverse, ranging from individuals and micro businesses with simple tax affairs to large partnerships and multi-national businesses.

8.3. Over the past few months, we have listened to the concerns of small businesses and we have made a number of changes to the proposed design to ease the transition to MTD. The detail of these changes are set out in the earlier chapters of this consultation document.

8.4. As mentioned, unincorporated businesses will make the transition to MTD first (from April 2018). Therefore, the detail and options being discussed elsewhere in this consultation focus on these businesses. However, given the range of businesses ultimately affected our initial assessment of impacts is based on available data for small businesses (covering both unincorporated and incorporated) with less than 20 employees.

8.5. HMRC wants to fully capture the impacts across all businesses, and improve our understanding of the population groups affected; the time businesses might take to comply with the new requirements; digital skills; issues around software, for example, design, costs and what different businesses might require; and the use of agents, including by those currently unrepresented. We aim to develop this understanding throughout 2016, consulting widely with an extensive range of stakeholders. This work will also include making early and better use of customer insight, analysis and detailed case studies.

Overview

8.6. HMRC's initial assessment of the impact of MTD is that overall it will lead to significant savings for businesses, contributing to HMRC's wider £400m burden saving target for businesses by the end of 2019/20. We have estimated ongoing administrative burden savings using a range of assumptions (based on small unincorporated and incorporated businesses with less than 20 employees), the first providing an estimate of £85m and the second an estimate of around £250m. More detail on these estimates is provided later in this chapter. We recognise that many businesses will incur costs, including time costs in making the transition to a digital way of transacting with HMRC. However, we do not yet have a granular understanding of what those costs will be to provide an estimate at this time.

8.7. In addition, we have now made a number of changes to the proposed design to ease the transition to MTD, and we are consulting on aspects of these changes. If any further changes are implemented to the design, following consultation, it is expected that the administrative burden savings for businesses will decrease. Where the income exemption is raised, more businesses will be removed from the scope of MTD and the expected savings for the business population will go down. If a 1 year deferral is introduced for a group of unincorporated businesses, it will take a further year to reach a 'steady state' in relation to these administrative burden savings. We are also seeking views on what financial support it might be reasonable for the government to provide in relation to the costs of investing in new IT, software (where free software offers insufficient functionality for the business) and/or training. It is therefore difficult at this stage to understand the potential effects on the administrative burdens savings estimates set out in the paragraph above.

8.8. We will consult widely with interested parties during 2016 to improve our understanding of the impacts on businesses. We are seeking submissions from businesses, their professional bodies and other representatives with their considered views on business impacts, and suggestions for how the government can mitigate those impacts. Accordingly, we will review and update our initial assessment of the business impacts as the MTD policy is refined over the consultation period in 2016 and we continue to further develop our understanding.

8.9. An updated impact assessment will be included in the Tax Information & Impact Note which will be published alongside draft legislation.

8.10. We will consider the impacts in the context of the parallel MTD and tax simplification consultations also being published.

The population affected by the changes

8.11. The changes will affect most of the 5.4 million private sector business population (Department for Business, Innovation & Skills: "*Business Population Estimates for the UK and regions 2015*"). This includes 3.3 million self-employed individuals, 1.6 million companies and over 400,000 ordinary partnerships. Out of the total business population, there are 1.3 million employing businesses and 4.1 million non-employing businesses. 2.4 million businesses are registered for VAT or PAYE. The changes will also affect around 900,000 landlords. As mentioned earlier though, HMRC's initial assessment of impacts is based on small businesses (covering both unincorporated and incorporated) with less than 20 employees.

8.12. Businesses and landlords who cannot engage with HMRC digitally will be exempted from the requirements of MTD, that is, they will not be required to maintain digital records or provide summary information to HMRC, as described in Chapter 5 of this document. Alternative processes will be provided for this group. The exempted businesses are included within the overall business population numbers set out above.

8.13. As mentioned earlier, all unincorporated businesses and landlords with annual incomes below a threshold (to be determined, but not less than £10,000) will be entirely exempted from the new obligations. It is also proposed to delay implementation for a limited group of businesses and landlords with annual incomes above that threshold. We are consulting on the appropriate income thresholds for both exemption and deferral. If any further changes are implemented, following consultation, it is expected that this will impact the population affected.

8.14. Any additional groups or entity types that should be exempted from the digital update requirements will be considered as part of the consultation process.

8.15. Businesses that are part of the first phase to join the new regime in 2018 will be able to volunteer to be part of user testing from the second half of 2016 and throughout 2017.

Current insight

8.16. HMRC is currently further developing its insight across the affected population. From our research and engagement so far we recognise that impacts across the diverse business population will vary. Our approach is to differentiate between the unrepresented (those not using an agent); those who cannot engage digitally; those who are likely to require digital assistance; and individuals in scope who may not view themselves as a business.

8.17. Overall, the impacts of the new requirements will depend on a range of factors, such as the complexity of the business, integration of record-keeping, and the business's current level of digitalisation, and one or more of these factors may apply. A business's current level of digitalisation and complexity will be significant factors in determining how smoothly it will transition to the new arrangements. Less complex businesses, for example, those that are cash-based, may find the transition to the new arrangements relatively smooth.

8.18. From our engagement so far, we recognise that a number of micro businesses and landlords with small property holdings may be less familiar with the use of digital tools than others, and may therefore be relatively more impacted by digital capability issues than the rest of the wider business population. Businesses with a turnover in the region of £1m or more are more likely to already use accounting software and therefore to find the MTD transition relatively straightforward.

8.19. We also recognise that there are other factors which could more adversely affect parts of the business population, including access to digital, inconsistent income streams, disability, and demographic factors.

Those who cannot engage digitally and those requiring support

8.20. We accept that businesses will need support in the transition to dealing with their tax affairs digitally and a minority will be unable to adopt or use digital tools. We also recognise there is a distinction to be made between impacts for individuals and businesses who cannot engage digitally and those requiring assistance or support.

8.21. We will build on our understanding of different categories of businesses who either cannot engage digitally with HMRC or those who will require help and support to move to the new regime. We know that this is an important area from our engagement with stakeholders, and the support needed to help businesses engage with HMRC digitally is a key focus of current HMRC research.

Current assessment of impact of the changes

8.22. We recognise that the transformational changes of moving to keeping digital records and more regular reporting are likely to result in one-off and transitional costs for some businesses. Over the longer term, we expect that the changes will reduce ongoing administrative burdens for businesses when they are operating in the new digital environment, as detailed later in this chapter.

8.23. At this stage, as set out earlier in this chapter, our initial assessment has been made using available data covering small unincorporated and incorporated businesses with less than 20 employees. The modelling of the impacts presented in this chapter covers the period to 2020/21 and is based on the phased introduction of the MTD changes, that is, Income Tax and National Insurance contributions from April 2018, VAT from April 2019 and Corporation Tax from April 2020.

Reducing burdens

8.24. At Autumn Statement 2015, the Chancellor announced a target for HMRC to reduce the costs to business of tax administration by £400m by the end of 2019/20. We expect that MTD will make a significant contribution to achieving this target.

8.25. MTD is at the heart of HMRC reforms to transform the administration of tax so it is more effective, more efficient and simpler for taxpayers to use. This will see the introduction of simple, secure and personalised digital tax accounts for businesses and individuals. HMRC will abolish the annual tax return for all businesses altogether.

8.26. By 2020, most businesses, self-employed people and landlords will be required to use digital tools to keep their business records and to provide regular updates of information, which will be played back to them via their online HMRC digital tax account. HMRC will ensure that free digital tools are available to enable this.

8.27. Taxpayers will be able to view an up to date picture of their tax affairs, providing greater certainty about tax due and entitlements. Targeted guidance and tailored alerts will make them aware of relevant obligations, entitlements and reliefs. Universal use of digital tools will help businesses to manage their affairs effectively and to understand their tax position more easily.

8.28. HMRC predominantly utilises the Standard Cost Model (SCM) methodology to estimate business impacts. The SCM represents the cost of complying with the tax system for a normally efficient business. This provides a consistently calculated and informed set of estimated costs for each tax obligation, averaged across the entire business population. In testing the impact of MTD on ongoing administrative burdens for businesses, we have looked at the time businesses spend complying with HMRC tax obligations: businesses will typically spend time gathering, collating and assessing their financial information, preparing and calculating their tax position, and then reporting to HMRC.

8.29. The SCM estimates represent our initial assessment of impacts on business. We recognise that these are broad estimates and we will review and test this analysis and our assumptions through extensive engagement and consultation with businesses, and through further research and analysis. HMRC aims to understand how different business sizes and sectors will be impacted, and we will make use of broader customer journeys to better reflect real business practice.

8.30. For our initial analysis of the ongoing impact on administrative burdens, we have considered two scenarios, which produce very different estimates of administrative burden savings at £85m and £250m (based on available data for small unincorporated and incorporated businesses with less than 20 employees). Both scenarios assume 42 tax obligations are in scope for changes proposed under MTD. These obligations include providing HMRC with the information required for a business Income Tax return, completing a partnership tax return, making payments on account of Income Tax and Class 4 National Insurance, submitting a VAT return and making Corporation Tax payments.

8.31. In the first scenario, time spent on these obligations would reduce by around 60% overall, and it is assumed that 2% of those businesses who use an agent choose not to do so under MTD. However, ongoing agent and software costs are not expected to change in this scenario. The potential ongoing savings to businesses based on this first scenario would be around £250m.

8.32. In the second scenario, the overall reduction in time for the same obligations is assumed to be lower (30%), we assume all those who use an agent continue to do so and ongoing agent and software fees increase by 2%. In this scenario the ongoing savings to businesses are estimated to be £85m.

8.33. These two scenarios highlight the potential range in how businesses will be impacted. We want to better understand the reality for businesses. Therefore, we will work extensively with stakeholders throughout 2016 to gain an in-depth understanding of the impacts from the perspective of businesses and further develop our initial evidence base to ensure the final design is focused on reducing burdens. The final estimate of the impacts could be different from both the scenarios represented here.

Question 39: Do you believe that there is the opportunity for MTD to create savings for your business? What percentage time reductions would you see from the following?

a) Targeted software tax guidance (prompts and nudges to get information right first time).

b) Gathering, collating and inputting data.

c) Reporting obligations through providing regular updates.

d) Any other potential savings not covered above.

Question 40: Do you think there are different business sectors or sizes likely to benefit more from MTD? If so, what would these be?

Transition to the new arrangements and one-off costs

8.34. On the basis of our initial analysis and current understanding, we expect businesses will incur one-off transitional costs in changing their practices to move to more real-time digital record-keeping, such as:

- time spent in familiarising themselves with the new digital tools and quarterly submission of information;
- purchase of new apps and software and/or upgrading existing software. This will depend on what free software is available from the market, and take-up; and
- some businesses may need to purchase hardware or upgrade existing hardware, although we think this is likely to be a small minority.

8.35. Generally, a one-off cost takes place in the first year or so that a policy comes into force and is linked to the business needing to make one time adaptions to be able to meet their tax obligations.

8.36. We recognise that this is an area where we need to develop our evidence further to fully and accurately capture the impacts of MTD. We will continue to develop our initial evidence in relation to one-off costs.

8.37. Currently, over 5 million users have already logged on to their business digital tax account, and generally UK businesses have a high level of digital engagement, although this varies according to size. Recent Ofcom statistics show significant increases over the past five years in ownership of devices making digital access more available. For example, 54% of homes now own a tablet device, compared with only 2% in 2011, and 66% of UK adults now have a smartphone, up from 39% in 2012. Government research also shows that 97% of small and medium-sized businesses have access to online services. So, many businesses and individuals already have access to the required digital tools.

8.38. We recognise that some micro businesses and individuals could incur costs in purchasing hardware or accessing broadband to meet the new requirements. We are expecting that capital costs (say, acquiring a computer or smartphone) won't impact significantly across the entire business population, and these costs may be tax deductible. As mentioned, we are also seeking views on what financial support it might be reasonable for the government to provide in relation to the costs of investing in new IT, software (where free software offers insufficient functionality for the business) and/or training. We plan to explore all of this further to inform our impact assessment.

Question 41: What costs might you expect your business to incur in moving to the new regime? Please provide details of the costs for:

a) **Time spent in your business familiarising with the new processes and conversion to these new processes.**

b) **Software expenditure costs (new or upgrading software).**

c) **Hardware expenditure costs (purchase of a computer, tablet device, etc).**

d) **Any other costs which are not covered above.**

Ongoing costs

8.39. In addition to the one-off transitional costs discussed above, some businesses may incur ongoing costs in complying with the changes. However, we recognise that there are gaps in our evidence and we will be developing this work over the next six months.

8.40. We would expect a majority of businesses who currently file returns to move to digitally engaging with HMRC as a result of MTD with consequent savings, as outlined above. Those who are unable to engage digitally will not be forced to do so.

Question 42: Do you expect that your business will incur additional on-going costs as a result of these changes? Please provide the details of the additional costs or time for:

- **a) Additional support from your accountant or tax agent.**
- **b) Additional time spent gathering, collating and inputting data.**
- **c) Additional time reporting obligations through providing regular updates and any end of year activity.**
- **d) Any other costs or time spent not covered above.**

Question 43: Will particular businesses (e.g. partnerships) experience more difficulty in adapting to the changes? If so please provide details, including any additional one-off costs or ongoing costs.

Agents

8.41. For the significant part of the business population that uses agents we need to understand how MTD changes will affect both the businesses and their agents.

8.42. Our current understanding is that the majority of businesses are unlikely to change their arrangements for managing their tax affairs, however we believe that simplified processes and software might give some businesses the confidence to deal with their tax affairs in-house rather than use an agent.

8.43. We recognise the key role that agents are likely to play in educating and supporting businesses through the transition to MTD and acknowledge potential costs associated with this.

8.44. On the basis of more timely interaction with tax, we expect that heavy work patterns occurring annually at the tax year end should reduce under the new regime, spreading workloads more evenly over the year.

8.45. We also expect there may be opportunities to improve businesses' record-keeping under the new system, which should free up scope for professional advisers to provide more qualitative advice and spend reduced time on compilation of information.

Question 44: If you are an agent, please provide details of how these changes will impact on your own business, including details of any one-off and ongoing costs or savings. How do you perceive that these changes might affect your clients?

Summary of Impacts

<table>
<tr><td rowspan="3">Exchequer Impact</td><td>2016-17</td><td>2017-18</td><td>2018-19</td><td>2019-20</td><td>2020-21</td></tr>
<tr><td>-</td><td>-</td><td>+10m</td><td>+310m</td><td>+625m</td></tr>
<tr><td colspan="5">HMRC estimated that the Making Tax Digital changes will help to reduce the tax gap and contribute £945 million to the Exchequer by 2020-21. This costing has been certified by the Office for Budget Responsibility (OBR) and the updated estimate is published in table 2.2 of Budget 2016. Estimates were based on the exemptions previously announced at Autumn Statement 2015. Further changes that extend the exemption to include primary income and increase the exemption income threshold will reduce the exchequer benefits. If a 1 year deferral is introduced for a group of unincorporated businesses, some of the exchequer benefits will be delayed. The impact of further changes will be estimated following the consultation process and will be subject to OBR review and certification.

The costing has been updated from Autumn Statement (AS) 2015 to take into account the latest receipt information, based on OBR determinants. Compared to AS 2015, the exchequer impact has increased from £920m to £945m over the scorecard period, then £625m each year thereafter, due to an improvement in SA and VAT liabilities growth. All the other assumptions in the costing remain unchanged.

The estimates represent tax gap savings arising as a result of more timely and accurate record-keeping. These revenue benefits are calculated following the general approach which is: revenue benefit = tax base x proportion of tax base covered x behavioural response.

Revenue lost to HMRC due to errors and failing to take reasonable care was estimated at £6.5 billion in 2013/14. The methodology behind this estimate is published in Measuring Tax Gaps 2015. To calculate the revenue benefit, assumptions were applied to break down the £6.5 billion figure into revenue lost from small businesses within the scope of MTD, and due to errors and failing to take reasonable care. These were then projected forward to 2020/21 by assuming it will grow in line with the OBR's forecast tax liabilities.

Take-up rates were estimated based on the phased introduction of the changes, that is, Income Tax and National Insurance contributions from April 2018, VAT from April 2019 and Corporation Tax from April 2020.</td></tr>
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	The behavioural response is the proportion of tax loss that will be prevented as businesses change their behaviour as a result of the new requirements. This was estimated from a series of workshops with operational experts, reviewing risks found in enquiries and considering which are related to record keeping failures and how much they would be impacted. The estimates obtained were then validated against the existing research base.
Economic Impact	This measure is not expected to have any significant macroeconomic impacts.
Impacts on individuals, households & families	This measure impacts on individuals who run their own business to the extent reflected in the 'Impact on businesses' section. The measure is not expected to impact on family formation, stability or breakdown.
Equalities Impacts	HMRC does not have evidence to suggest this measure will have a significant or disproportionate impact on groups with legally protected characteristics, as recognised in the Equality Act 2010. Publicly available statistics indicate that 54% of homes now own a tablet device, 66% of UK adults now have a smartphone and 97% of small and medium-sized businesses have access to online services. So, we would expect that the digitally excluded population to be relatively small, although some of the segments impacted by the changes may be disproportionately represented within this population. Individuals and businesses with protected characteristics under the Equality Act who fall within the current legislative definitions of 'digitally excluded' will be exempted from the digital record-keeping and update requirements and HMRC will provide non-digital alternative channels to them.
Impacts on businesses & civil society groups	The changes will affect most businesses, including micro and small businesses, and we recognise that the population that will be affected is diverse. This includes around 3.3 million self-employed individuals, 1.6 million companies, over 400,000 ordinary partnerships, around 900,000 landlords, and about 600,000 businesses with income from different sources (for example, both self-employment and property). The changes will improve the quality of record-keeping for businesses, reducing the likelihood of mistakes and helping them to manage their affairs more effectively (further detail was provided earlier in this chapter.) The expectation is that the changes will reduce ongoing costs to business by removing - either fully or partially – some of the current information obligations placed on businesses. This

	would reduce the time businesses spend gathering and inputting data in order to meet their information obligations, and move the focus for the business more towards checking and correcting information. Once businesses have transitioned to regular digital record keeping, the obligation to provide more regular updates to HMRC is expected to result in a reduction in burdens compared to the current once a year reporting requirements. Digital tools may give some businesses, who currently use an agent to manage their tax affairs, the confidence to do this work themselves which may also save costs. Our initial analysis of the ongoing impact on administrative burdens involved considering two scenarios, which produced very different estimates of administrative burden savings at £85m and £250m. This was based on small unincorporated and incorporated businesses with less than 20 employees. Both scenarios assumed 42 tax obligations were in scope for changes proposed under MTD. These obligations included providing HMRC with the information required for a business Income Tax return, completing a partnership tax return, making payments on account of Income Tax and Class 4 National Insurance, submitting a VAT return and making Corporation Tax payments. In the first scenario, it was assumed that time spent on these obligations would reduce by around 60% overall, and that 2% of those businesses who use an agent would choose not to do so under MTD. However, ongoing agent and software costs were not expected to change in this scenario. The potential ongoing savings to businesses based on this first scenario were estimated at around £250m. In the second scenario, the overall reduction in time for the same obligations was assumed to be lower (30%), and that all those who used an agent would continue to do so and ongoing agent and software fees would increase by 2%. In this scenario the ongoing savings to businesses were estimated to be £85m. These two scenarios highlight that there are gaps in our understanding of a number of factors which would affect the business impacts. The SCM estimates represent our initial assessment of impacts on business. We recognise that this is a broad estimate and we will review and test this analysis and our assumptions through extensive engagement and consultation with businesses, and through further research and analysis. HMRC aims to understand how different

	business sizes and sectors will be impacted, and we will make use of broader customer journeys to better reflect real business practice. We will work extensively with stakeholders throughout 2016 to further develop our initial evidence base, and gain an in-depth understanding of the impacts from the perspective of businesses, to ensure that the final design is focused on reducing burdens. Therefore, the final estimate of the impacts could be different from both the scenarios represented here. It is expected businesses will incur one-off transitional costs in moving to the new arrangements. The costs are likely to cover: ● Time spent in familiarising themselves with the new digital tools and quarterly submission of information. ● Purchase of new Apps & software and/or upgrading existing software. This will depend on what free software is available from the market, and take-up. ● A small minority of businesses may need to purchase new hardware or upgrade existing hardware. Quantitative estimates of the one-off transitional costs and ongoing savings will be developed through ongoing research and consultation with businesses to ensure that these are reflective of the final software solution and MTD policy design. These estimates will be included in the Tax Information & Impact Note which will be published alongside draft legislation. The expectation is that the changes will reduce ongoing costs to business by removing – either fully or partially – some of the current information obligations placed on businesses. <u>Small and micro business assessment:</u> The MTD changes will potentially benefit small and micro businesses through improving the quality of record-keeping, reducing the likelihood of mistakes and helping businesses to manage their affairs more effectively. In the longer term, we expect that this will lead to a reduction in administrative burdens for these businesses, as described earlier in this chapter.

	We recognise by their very make-up that these businesses are likely to be more affected by one-off transitional costs and digital capability issues, and may therefore find it more difficult to move to the new digital requirements. Civil Society organisations may potentially see an increase in demand for help and advice from digitally disadvantaged groups in transitioning to the new requirements. The number of businesses and individuals affected and the impacts on them will be reviewed in light of consultation responses.
Operational (HMRC or other)	MTD builds on the business digital tax account that over five million users are accessing, hosting the full range of services that businesses need to register, account for and pay their taxes. From April 2018, businesses will be required to provide data in-year to HMRC systems using digital tools, removing the need to complete separate tax returns. This will result in significant operational changes for HMRC in moving from current systems and ways of working to the new model. This will include enhanced risk rules which will build in upstream compliance through nudges, prompts and personalised messaging for businesses, helping HMRC tackle non-compliance earlier and reducing the need for expensive interventions later on. The details of the proposal are being considered in this consultation therefore it is not possible to provide further details of the impacts on HMRC at this stage.
Other Impacts	It is expected that these changes will also affect a significant number of agents acting for businesses.

9. Summary of Consultation Questions

Chapter 2. Acquiring Digital Tools

Question 1: What are the challenges for businesses that currently keep their records on paper or simple spreadsheets in moving to an integrated software package for record keeping, and what further measures or support would help businesses to meet these challenges?

Question 2: What information and guidance would you find helpful in choosing the appropriate software for your business?

Question 3: What types of business should a free software product cater for? What functionality would be necessary in a free software product?

Question 4: What level of financial support might it be reasonable for the government to provide towards investing in new IT, software or training, to whom should such support be aimed, and what is the most appropriate form for delivering such support?

Question 5: What other forms of support would help to make the transition to Making Tax Digital easier?

Question 6: What facilities would make it easier and more secure for businesses to enrol for Making Tax Digital and use software regularly?

Chapter 3. Digital record keeping

Question 7: Do you have any comments about the practicalities of keeping evidence of transactions and trading when using digital tools?

Question 8: Do you agree with the minimum transaction data fields proposed for trading businesses, including retailers? What other data fields might the record keeping software usefully include as a minimum?

Question 9: Do you have any comments about reflecting the current VAT requirements in MTD-compatible software?

Question 10: Do you have any comments on the additional data capture requirements for property income and capital gains?

Question 11: What should the minimum categorisation in the software be? Would additional sub-categories be useful?

Question 12: Do you have any comments on how businesses should reflect transactions and expenditure with non-deductible elements in the software?

Question 13: What prompts and nudges would be most useful to businesses?

Chapter 4. Establishing taxable profit

Question 14: Do you agree that businesses should have the choice as to when to record accounting adjustments?

Question 15: Do you agree that business should have the flexibility to reflect reliefs and allowances when they choose?

Question 16: What do you consider is the most appropriate approach to reflecting the effect of the personal allowance on an individual's taxable business profit?

Question 17: Is this the right treatment of partnerships? Are there any additional partnership issues that need to be considered?

Question 18: Is this the right treatment of individuals who receive income from property, let jointly?

Question 19: Is this the right treatment of subcontractors within the Construction Industry Scheme? Are there any other CIS issues that need to be considered?

Chapter 5. Providing HMRC with updates

Question 20: Do you have views on how detailed the summary data in the updates should be, and whether the level of summary data should be different depending on the size of the business?

Question 21: Do you have any comments on the categorisation of summary data in the updates?

Question 22: Do you have any views on what VAT data the updates should contain? Do you have any views on the advantages or disadvantages of including VAT scheme data in the updates? If so, which schemes and which data should be included in the updates?

Question 23: What flexibility around update cycles would be useful?

Question 24: Do you agree businesses should be allowed one month to submit their update? Would any problems be caused for VAT registered businesses by standardising the time limit for updates for all taxes?

Question 25: What method of deriving a business's start date for providing updates under Making Tax Digital would be most straightforward for businesses?

Question 26: Do you wish to make any comments about the operation of 'in-year' amendments to updates for the purposes of profits taxes or VAT?

Chapter 6. 'End of Year' Activity

Question 27: Do you agree that the process of finalising the regular updates should be separate to the regular updates?

Question 28: Do you agree that businesses should have nine months to complete any End of Year activity?

Chapter 7. Exemptions

Question 29: What criteria should be applied in determining whether to exempt a particular business or business type from the requirements of MTD?

Question 30: Should charities be exempt from the requirements to maintain digital records and to update HMRC at least quarterly?

Question 31: Should trading subsidiaries of charities be exempt from the requirement to maintain digital records and to update HMRC at least quarterly?

Question 32: Should CASCs be exempt from the requirement to maintain digital records and to update HMRC at least quarterly?

Question 33: Should businesses within the insolvency process be included within the scope of the requirement to maintain digital records and to update HMRC at least quarterly; and are any special arrangements required for this group?

Question 34: Which businesses should be included within a consistent definition of persons ‘unable to engage digitally’?

Question 35: Do you agree that £10,000 annual income is an appropriate threshold for exempting businesses from Making Tax Digital? Do you have any other comments on how the exemption should operate?

Question 36: Should the smallest unincorporated businesses that are not exempt have an extra year to prepare for Making Tax Digital? How should eligibility for this group be defined?

Question 37: Do you agree that the principles set out in Fig. 7.3 are the right ones to use in determining eligibility for an exemption? Are there any additional principles which should apply?

Question 38: Which additional groups (if any) should be exempt from the requirements to maintain digital records and to update HMRC at least quarterly?

Chapter 8. Initial Assessment of Impacts

Question 39: Do you believe that there is the opportunity for MTD to create savings for your business? What percentage time reductions would you see from the following?

a) Targeted software tax guidance (prompts and nudges to get information right first time).

b) Gathering, collating and inputting data.

c) Reporting obligations through providing regular updates.

d) Any other potential savings not covered above.

Question 40: Do you think there are different business sectors or sizes likely to benefit more from MTD? If so, what would these be?

Question 41: What costs might you expect your business to incur in moving to the new regime? Please provide details of the costs for:

a) Time spent in your business familiarising with the new processes and conversion to these new processes.

b) Software expenditure costs (new or upgrading software).

c) Hardware expenditure costs (purchase of a computer, tablet device, etc).

d) Any other costs which are not covered above.

Question 42: Do you expect that your business will incur additional on-going costs as a result of these changes? Please provide the details of the additional costs or time for:

a) Additional support from your accountant or tax agent.

b) Additional time spent gathering, collating and inputting data.

c) Additional time reporting obligations through providing regular updates and any end of year activity.

d) Any other costs or time spent not covered above.

Question 43: Will particular businesses (e.g. partnerships) experience more difficulty in adapting to the changes? If so, please provide details, including any additional one-off costs or ongoing costs.

Question 44: If you are an agent, please provide details of how these changes will impact on your own business, including details of any one-off and ongoing costs or savings. How do you perceive that these changes might affect your clients?

10. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.

How to respond

A summary of the questions in this consultation is included at Chapter 9.

Responses should be sent by 7 November 2016 by e-mail to:
makingtaxdigital.consultations@hmrc.gsi.gov.uk

or by post to:

HM Revenue and Customs
Making Tax Digital for Business Policy Team
Room 3C/12
100 Parliament Street
London
SW1A 2BQ

Please do not send consultation responses to the Consultation Coordinator.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from HMRC's GOV.UK pages. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentially can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

ANNEX A

Income and expense categories contained in the income from self-employment pages of the Self Assessment tax return

Income

- Takings, fees, sales or money earned
- Any other business income

Expenses

- Cost of goods bought for resale or goods used
- Construction industry – payments to subcontractors (only relevant to construction industry – not visible to other businesses)
- Wages, salaries and other staff costs
- Car, van and travel expenses
- Rent, rates, power and insurance costs
- Repairs and renewals of property and equipment
- Phone, fax, stationery and other office costs
- Advertising and business entertainment costs
- Interest on bank and other loans
- Bank, credit card and other financial charges
- Irrecoverable debts written off (not relevant for cash basis)
- Accountancy, legal and other professional fees
- Depreciation and loss/profit on sale of assets
- Other business expenses
- Goods and services for your own use