



HM Revenue  
& Customs

# Making Tax Digital:

## An evaluation of the VAT service and update on the Income Tax Service

Budget 2020

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# 1 Executive overview

- 1.1 The purpose of this document is to provide an update on the introduction of Making Tax Digital (MTD). This responds to requests from stakeholders to review the roll-out of MTD for VAT before the government decides on the next phases of MTD. The document captures progress and learning from the roll-out so far, drawing on available evidence at this stage. HMRC will continue to discuss and monitor progress with representative bodies and taxpayers, to ensure that future plans for MTD reflect this learning.
- 1.2 MTD is a key part of the government's ambition for HMRC to become one of the most digitally advanced tax authorities in the world. We would like to recognise the significant contribution of tax agents, software providers and businesses across the country in working so professionally and constructively to implement this significant and important modernisation.
- 1.3 The Government Transformation Strategy 2017<sup>1</sup> set out the government's vision for transforming the relationship between citizens and the state by providing citizens and businesses with a more coherent experience when interacting with government services - one that meets the raised expectations set by the many other (non-government) services and tools they use every day. MTD helps the government to meet this ambition.

## Overview of Progress

- 1.4 **Making it easier for businesses to get their tax right:** As businesses become increasingly digital, the use of digital record-keeping tools helps prevent businesses from making errors. This addresses the part of the tax gap that is attributable to error and failure to take reasonable care by significantly reducing the opportunity to make some types of mistake in tax returns, principally simple arithmetical and transposition errors.

- 1.5 The latest published tax gap figures showed that avoidable mistakes made by taxpayers cost the Exchequer more than £9.9 billion in lost revenue 2017-2018<sup>2</sup>. By supporting businesses to get their tax right, MTD is designed to prevent these types of errors, reducing the tax gap, supporting public services and levelling the playing field for businesses.

## Benefits of digital filing and record-keeping

- 1.6 **Digital record-keeping tools:** MTD requires businesses to use digital record-keeping tools and submit tax return data directly from those records using MTD-compatible software. It harnesses the freedom provided by Application Programming Interfaces (APIs). This has energised the market for software, resulting in a rich array of products being available to businesses and in turn providing businesses with more choice over what tools they use to run their business and take control of their tax affairs.
- 1.7 Through MTD, the UK now has a tax system where, for the first time, businesses are able to make meaningful choices that integrate how they keep records and file their VAT returns. Some businesses have chosen to incorporate MTD into their bespoke IT systems, allowing tight integration with other business processes. Others have chosen an off-the-shelf solution that, in addition to keeping their tax affairs in order, gives them new tools and provides new insight into the performance of their business. Others simply want to continue using the spreadsheets they are familiar with, in conjunction with a piece of 'bridging' software (some of which are available to businesses for free), to upload their VAT returns directly to HMRC. They now have the freedom to make that decision based on the needs of their business. Alongside this, there is a wide range of products for agents, ensuring they can continue to act on behalf of their clients in this new digital landscape. In response to feedback, we have improved the search tools on the GOV.UK website product page, to help businesses identify suitable products.

<sup>1</sup> [gov.uk/government/publications/government-transformation-strategy-2017-to-2020](https://www.gov.uk/government/publications/government-transformation-strategy-2017-to-2020)

<sup>2</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/820979/Measuring\\_tax\\_gaps\\_2019\\_edition.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820979/Measuring_tax_gaps_2019_edition.pdf)

- 1.8 **Productivity increases:** The benefits that these kinds of tools can bring to businesses are clear. The Enterprise Research Centre (2018) found that, for micro-businesses, web-based accounting software delivered productivity increases of 11.8%<sup>3</sup>. The Lloyds Bank UK Consumer Digital Index 2019 found that those who are the most digitally engaged save a day a week in administration by going digital. HMRC's research<sup>4</sup> has also shown that businesses who fully integrate their accounting and tax software report spending less time on their tax..

### Delivery of MTD

- 1.9 **Staggered roll-out of MTD:** The delivery of MTD is being staggered. Following stakeholder feedback about the pace of change, the decision was taken in 2017 to slow the roll-out of MTD, with the initial requirement to join in 2019 limited to VAT and applying only to those with turnover above the VAT threshold (currently £85,000). This approach ensured that those businesses who would find the transition to MTD easiest were the first required to use it. More than 98% of VAT returns were already being filed online.
- 1.10 **The million-plus milestone:** By 9 March 2020 more than 1.4 million businesses had joined the new service and more than 4 million VAT returns had been submitted successfully using MTD-compatible software.
- 1.11 This rate of progress represents a significant milestone in the digitisation of the UK's tax service. More than 83% of businesses in scope have signed up to the service and 95% of those who had signed up on time, successfully made their first return through the service on time. For monthly filers, whose first return was due by 7 June, more than 91% have now signed up. Those who are yet to join are being reminded and offered further support.
- 1.12 **A smooth system for payments and repayments:** More than £41 billion of payments and over £13 billion in repayments have successfully flowed through the new IT system.

<sup>3</sup> [www.enterpriseresearch.ac.uk/](http://www.enterpriseresearch.ac.uk/)

<sup>4</sup> [www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses](http://www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses)

### Stakeholders' Experience

- 1.13 **Vast majority of businesses and agents meet requirements:** Overall, the vast majority of businesses and agents have proved able to meet the requirements of the first phase of MTD. Many businesses and agents had already recognised the benefits of going digital, so for them, MTD is a natural extension of the way they were already choosing to run their business. The government recognises the effort that many businesses and their agents have put into the move to MTD, primarily researching and choosing new software and learning how to use it.
- 1.14 **Agents help businesses maximise productivity and growth:** The Lloyds Bank Digital Index has shown that the most digitally engaged can save a day a week in administration by going digital. For agents this means that they can shift their focus from compliance and correcting basic transposition and calculation errors towards more advisory services. They can apply their insight into the financial health of businesses to help them identify opportunities to maximise productivity and growth.
- 1.15 **MTD Transition Challenges:** However, for a small number of businesses and agents, the transition to MTD has proved more challenging. In particular, some agents have reported issues setting up their Agent Services Account (ASA) and acting on behalf of their clients for MTD. HMRC is learning the lessons from the roll-out of MTD for VAT and will continue to make improvements to the service. We are carefully monitoring the transitional administrative costs being experienced by businesses, drawing on evidence from representative bodies and our own research. Experience is varied, with some finding the transition smooth, and others - particularly those continuing to use spreadsheets with bridging products - finding the transition more difficult. We continue to keep this under review.

- 1.16 **Priority improvements to agent services:** HMRC has engaged with agents and, in response to their concerns, action has already been taken on priority improvements to agent services. HMRC recognises there is still more to do and intends to continue its engagement with agent professional bodies, building on the constructive engagement throughout the implementation of MTD for VAT to date.
- 1.17 **MTD stimulates markets:** The software industry has been a key player in the successful roll-out of MTD to date. MTD has stimulated a vibrant and competitive market in VAT products, offering customers a wide choice of products with different functionality and at different price points. This includes some that are free.
- 1.18 **HMRC to improve VAT software choices page to help businesses:** HMRC set up the VAT software choices page in response to customers telling us they needed help choosing software. HMRC is continuing to improve the software choices page to improve searchability and help businesses, particularly smaller ones without an agent, choose a product that meets their needs.
- 1.19 **Stakeholders play a vital role:** HMRC recognises the vital role its stakeholders, particularly in the accountancy profession and the software industry, have played in the implementation of MTD for VAT and is grateful for this. HMRC continues, via a variety of working groups and regular meetings, to monitor the operation of the existing service to make improvements. It will continue to work with stakeholders to ensure the lessons learned from MTD for VAT inform the next phases of MTD.

## First stage evaluation

- 1.20 Whilst it is too early to evaluate the impact MTD will have on the Tax Gap, there are a number of conclusions can be drawn from the roll-out of the first stage of mandate for MTD:

- a. Some businesses have found operating MTD is easier than they thought. HMRC research<sup>5</sup> found that MTD for VAT has allowed businesses with fully integrated software to manage their finances in real-time, with the relative simplicity of having automated processes motivating them to do so. These businesses now only enter information once, making it easier to spot and correct mistakes at source. Much third-party software has intuitive and easy-to-use navigation and dashboards to assist with this. One business who previously used paper has said:
- “Initially you have to take it on which is a little overwhelming but once you’ve gotten past the first month or two, you suddenly realise that the process of doing it is so simple, and if you have questions there are people to ask. Once you’ve done it once or two quarters, or a year in you’re just completely in control.”
- b. We understand that some businesses and agents have incurred more costs than expected in making the transition to digital filing. HMRC will continue to support businesses in finding affordable software providers for their requirements. The software industry has produced a wide choice of more than 500 MTD-compatible software products for businesses looking to choose software. As at 9 March 2020, this included 13 free products, around 55 trade-specific software products and 13 accessible products (that meet cognitive, visual, hearing and motor needs). More than 250 subscription-based software products already being used by many small businesses were upgraded to MTD for free. Invariably, costs will differ from business to business and are influenced by factors including size and complexity of business, degree of digital capability and cost and functionality of software solution employed.

<sup>5</sup> [www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses](https://www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses)

- c. Some businesses have already reported wider productivity gains and reductions in input errors. Our research<sup>6</sup> found that those businesses who fully automated their processes reported reduction in input error when compared with previous methods. Businesses who have chosen to fully automate their records, for example linking to their bank accounts, also benefited from saving time and having a positive attitude towards VAT.
- d. HMRC has delivered the required technical solutions needed for MTD. Testing the service through the pilot was invaluable both in identifying and resolving issues and in improving guidance and support, as was continuing to monitor and develop the service once larger volumes started to use it. This allowed HMRC to drive out issues based on real people's experiences of the service. As a result, the majority of businesses who have signed up have been able to do so and make submissions without experiencing any issues.
- e. MTD has encouraged the development of a thriving software market. Our work with software developers confounded concerns that there would not be sufficient choice available to businesses and their agents and that there wouldn't be low-cost or affordable options for those who needed them. HMRC is now focussing on helping businesses make the right choices for them when picking from the array of products available. There are also some free software products available to support MTD for VAT. Building on the successful and important collaboration between HMRC, the software industry, and representative bodies for businesses and agents has been key to the success of MTD for VAT.
- f. Early indications are that mandation of MTD has the potential to be a significant driver of technology uptake among businesses. For many MTD has merely been the catalyst for a business to consider its wider approach to technology and how it can harness it to drive profits and growth.
- g. MTD roll-out has benefitted from a strong collaboration with representative bodies. Representative bodies have played a critical role in helping shape the roll-out of MTD and will be fundamental in helping HMRC design the next stage of the Programme.
- h. Although starting with a low level of business awareness, HMRC research<sup>7</sup> has demonstrated that by July 2019, business awareness of MTD had grown significantly. There were also positive findings around preparedness, with 91% of businesses who were aware of MTD having made preparations by July 2019. This research has helped to strengthen HMRC's communication plans to ensure businesses are well-informed and supported about MTD. For example, the department ran a well subscribed series of webinars for businesses and agents, offering guidance and support, as well as writing to all affected businesses individually and providing written and video guidance on gov.uk.

## Conclusion

- 1.21 There is significant evidence that many aspects of the introduction of MTD have worked well, both for HMRC and its customers. It is also recognised that there is important learning which HMRC will need to apply to the next stages.
- 1.22 Businesses, such as a café in Orkney, have shared their experience of MTD with us through videos (Appendix B):  

"In terms of cost, it's minimal, it's not been prohibitive at all. It's been great going from paper to digital. Previously it would take hours manually editing and making returns to now having it all at the click of a button. Going digital has made an immense difference to the amount of time that I have free. More time to put into making cakes, spending time with customers and being able to plan staffing and other elements of the business that normally would be done at midnight."

<sup>6</sup> [www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses](https://www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses)

<sup>7</sup> [www.gov.uk/government/publications/monitoring-business-awareness-of-making-tax-digital](https://www.gov.uk/government/publications/monitoring-business-awareness-of-making-tax-digital)

“Accounting software helps to do the VAT submission online. It lets me see right away, very quickly, how much VAT I have to pay and how much I’m getting back, rather than having to think about signing papers and having to wait for things to come back. It’s all there right away, I’m not getting any surprises or shocks.”

- 1.23 Whilst there were many things that went well with the roll-out of MTD for VAT, we also acknowledge that there were problems. In considering the roll-out of the next stages of MTD, we will continue to consider and act on feedback from all sources, including the recent surveys undertaken by professional bodies. We have already begun to make improvements to our digital service and to the types of support offered to our customers. We will continue to investigate and monitor the issues experienced by businesses to ensure that the lessons are learned from VAT.
- 1.24 By 9 March 2020, already more than 270,000 smaller VAT businesses, more than a quarter of businesses below the VAT threshold, have voluntarily joined MTD. This shows that a modern, digital approach to managing their tax can work for businesses of every size.
- 1.25 HMRC has been running a small-scale pilot for MTD for Income Tax since 2017 with a handful of sole traders, landlords and their agents participating. This has allowed HMRC to test the sign-up and submission process with businesses, landlords and agents. We have been continuing to release functionality and this has allowed a small number of participants to finalise their tax through MTD without needing to submit a tax return.
- 1.26 HMRC is continuing to release functionality so that we can grow the pilot and test the system with more customers and with a wider range of income types. Over 1 million businesses and landlords are now eligible to join the pilot. This will allow more businesses and landlord to join MTD and benefit from the different way of working MTD brings.

For example, where some businesses previously may have taken all their paper records to their accountant once a year to fill out a Self-Assessment return, they will be keeping contemporaneous digital records, giving them a closer to real time view of how their business is performing, and supporting them in getting their tax right.

- 1.27 There are also benefits for agents of their clients taking part in the pilot. Instead of having to sort through receipts and work out what they are for, they will be able to concentrate on providing services that add value for their business and landlord clients. Many businesses are already engaging digitally in many parts of their life. For example, banking online, paying business rates online or using smart meters in their business premises. Capturing income and expenses much closer to the point of transaction will be easy, quick and more accurate.
- 1.28 Those businesses and landlords who join the pilot will be able to see, close to real time, the health of their finances, including which jobs or properties are profitable and where expenses have started to creep up. When they submit their automatically-generated quarterly summary updates of their income and expenses, they will receive a calculation showing them their emerging tax position, helping them budget for their tax throughout the year. The experience from many businesses in MTD for VAT is that over the full cycle of a business year, by integrating ‘doing tax’ into day-to-day record-keeping, businesses spend less time overall dealing with their tax affairs, we expect the same to be the case for MTD for Income Tax Self Assessment.

## 2 Background to Making Tax Digital

- 2.1 HMRC is delivering a modern, digital tax service for businesses and their agents through MTD. It will make it easier for businesses to get their tax right, saving time which can be devoted to maximising business opportunities, and helping to foster good financial planning. The shift to digital also supports increased productivity. For example, the Enterprise Research Centre (2018) found that for micro-businesses web-based accounting software delivered productivity increases of 11.8%<sup>8</sup>.
- 2.2 The latest published tax gap figures (2017 to 2018) showed that avoidable mistakes from taxpayers cost the Exchequer more than £9.9 billion in lost revenue that year. MTD is a step change in the way HMRC addresses that part of the tax gap. By requiring businesses to keep their records digitally and submit tax return data directly from those records using compatible software, MTD significantly reduces the opportunity to make some types of mistakes in tax returns, particularly simple arithmetical and transposition errors. This, in turn, is why it will save time which can be devoted to maximising business opportunities and helping to foster good financial planning.
- 2.3 Our estimates for error take into account both the errors in HMRC's favour and in the taxpayer's favour. The key reason that errors, on average, result in a net loss for HMRC is that sales are typically of more value than expenses, so when information is lost from the process it will on average result in a business declaring less VAT than they should. Our methodology for these estimates has been thoroughly checked by the Office for Budget Responsibility and support our view that MTD closes the tax gap. We have an evaluation programme in place to monitor this impact over time.
- 2.4 The mandate of MTD for VAT for businesses over the VAT registration threshold is currently forecast to deliver a reduction in the tax gap caused by error and failure to take reasonable care, leading to additional tax revenue (ATR) of £1.2 billion by 2023 to 2024, with steady state savings of around £300 million each year.
- 2.5 The government originally set out its vision and roadmap for MTD in 2015, with the ambition for HMRC to become one of the most digitally advanced tax authorities in the world.
- 2.6 Since then, HMRC has consulted extensively with stakeholders including representative bodies, tax agents, businesses and third-party software providers to help shape the design and operation of the new service. This included a formal consultation on the design of MTD for Income Tax and VAT during 2016.
- 2.7 More than 3,000 responses were received to the consultations. There was broad recognition that the move to a more digital way of doing tax is the right one. But not all businesses were confident of their ability to make the change and views differed on how quickly the changes should be rolled out. The pace and scope of change were the main areas of feedback.
- 2.8 The government published its response to the consultations in January 2017, setting out a number of changes in light of the feedback received. This included a commitment that there would be free MTD Income Tax software for small businesses with the most straightforward affairs. It also confirmed that businesses would be able to continue using spreadsheets for record-keeping, as long as these were combined with MTD-compatible 'bridging software' to send their returns digitally direct from the spreadsheet data.

<sup>8</sup> [www.enterpriseresearch.ac.uk/](http://www.enterpriseresearch.ac.uk/)

- 2.9 The government continued to listen to businesses and their agents. It announced in July 2017 that it would slow the pace of mandation, to give businesses, particularly smaller ones, more time to prepare. It limited the initial mandation of MTD to the 1.2 million VAT registered businesses above the VAT threshold (currently £85,000), requiring them to join MTD from 2019, but only for their VAT. It also announced that there would be exemptions for those who were unable to make the transition to digital and that those who were already exempt from online filing for VAT would be automatically exempted from MTD. Businesses with turnover below the VAT threshold were not required to join the service but could do so voluntarily.
- 2.10 At Spring Statement 2019 the government provided a further update that MTD would not be extended to other businesses or taxes in 2020, to give businesses and agents greater certainty and to help them plan. The government also reaffirmed HMRC's commitment to taking a light-touch approach to penalties in the first year of the MTD for VAT service. HMRC has been clear from the outset that its focus is on supporting businesses to transition to MTD and ensuring that the first steps of MTD are well evaluated. HMRC has not pursued digital record-keeping or filing penalties where a business is doing its best to comply. This reassurance was positively received by businesses as they made their transition to operating MTD.

# 3 Review of the Making Tax Digital service for VAT

## 3.1 Introduction

3.1.1 MTD for VAT is the first MTD service to operate at scale. The government's announcement in 2017 confirmed that around 1.2 million businesses would be required to start using the service in 2019. Most of these businesses were required to join the service and make their first VAT return through it for VAT periods starting on or after 1 April 2019.

To achieve this:

- i. HMRC needed to develop the IT infrastructure for MTD and test the MTD service. This included the MTD-compatible software businesses and agents would need to use the MTD service
- j. affected businesses needed to know that they were required to start using MTD and what they needed to do
- k. businesses needed to start keeping records digitally (if they were not already doing so) and choose and start using software that would enable them to use the MTD service
- l. businesses needed to join MTD and then start submitting their VAT returns through their MTD-enabled software, using the service
- m. provision needed to be made for businesses that would genuinely be unable to meet these new requirements, for example because they were digitally excluded.

3.1.2 As of 9 March 2020, more than 1.4 million businesses have signed up for MTD and more than 4 million VAT returns have been successfully submitted through the service. Already more than 270,000 smaller VAT businesses, more than a quarter below the VAT threshold, have voluntarily joined MTD.

3.1.3 In addition, in respect of MTD for VAT, more than £41 billion in payments has been processed through the new system. And more than £13 billion repayments have been issued to businesses who have submitted a repayment claim on their VAT return because their input (purchase) tax exceeds their output (sales) tax.

3.1.4 The government is satisfied on the basis of the available evidence that the MTD for VAT service is working. This chapter sets out key facts and observations on each element of the journey. It also identifies lessons learned that HMRC should take into account to make the service even better if the Government announces that MTD will be rolled out to other businesses and taxes.

## 3.2 Developing and testing the digital service

3.2.1 In April 2018, HMRC began a live pilot of the MTD VAT service, testing key elements of it on a small scale and then opening the pilot up more widely in October 2018. The pilot was designed to provide a robust test of the service in terms of end-to-end customer journeys, the support model and customer behaviour, allowing HMRC to identify and resolve issues before mandation.

3.2.2 Through the pilot HMRC identified a number of issues it needed to address. For example, the sequence in which some businesses signed-up to MTD and submitted their final pre-MTD VAT return, created issues with the timing and location of when and where the data was reflected in HMRC's systems. This required manual intervention by HMRC to correct. In response, HMRC made a small IT change and improved its online guidance to avoid this issue recurring.

3.2.3 During the pilot HMRC identified a number of issues and received feedback relating to agents' experience of setting up their Agent Services Account (ASA) and operating MTD on a client's behalf. For example, it became clear early in the public phase of the pilot that the guidance developed for agents did not give them enough detail about the steps they would need to follow to sign-up a client for MTD. The sign-up process required agents to set up an ASA and then link their existing clients to it, before they could sign them up to MTD.

- 3.2.4 **HMRC has delivered a number of improvements to the ASA.** As a result of this feedback from agents HMRC has redesigned the sign-up process to make it simpler for agents to complete. HMRC has also published a step-by-step guide setting out the stages an agent needs to go through. Links have been added from the account homepage to the MTD sign-up service and the MTD view and change service to make it easier for agents to navigate the different aspects. HMRC also started a fortnightly update email for agents to keep them abreast of improvements to the service, as well as providing information for those experiencing issues. Bespoke webinars were also delivered by HMRC that took agents through the sign-up process, step-by-step, in the live environment. These were well received and HMRC saw spikes in the creation of ASAs on the days of, and immediately after, agent webinars. We continue with our commitment to improve the ASA further.
- 3.2.5 By the end of March 2019 93,000 businesses had taken part in the pilot.
- 3.2.6 Almost all mandated businesses had the opportunity to file at least one return through the pilot. A small minority of businesses with more complex VAT requirements had their mandate deferred until October 2019, so that they would also have the opportunity to test the service before being mandated. This was generally positively received by business. These businesses were required to file their first return through MTD by 7 December 2019 if they file their VAT returns monthly, or between February and April 2020 if they file quarterly. This deferral was announced on 16 October 2018. About a third of these customers had signed up before their October mandate date. However, we have received feedback from a number of businesses and agents that they would have liked the pilot to be longer. The government has listened to this and for MTD for ITSA has ensured that there is a much longer pilot. Over 1 million businesses and landlords are eligible to join the pilot already. HMRC will continue the MTD for ITSA pilot and increase functionality to allow more businesses to voluntarily join the service in pilot phase.
- 3.2.7 In summary, the MTD for VAT pilot was successful in:
- providing an opportunity for the software industry to develop and test the products that businesses and agents would need for MTD
  - identifying a number of issues, so that they could be resolved before mandate
  - enabling HMRC to ensure the service worked end-to-end, including its guidance and the customer support model
  - giving businesses and agents the opportunity to test the service before they were required to join.
- 3.2.8 The pilot allowed HMRC to identify and resolve some issues that could have had an impact on large volumes of customers. However, there were inevitably others that surfaced only as numbers using the service increased after April 2019. For example, some businesses filed returns for incorrect (later) dates. Others joined the service but then sent their returns through the old VAT portal. These issues were identified through various routes, ranging from HMRC's internal monitoring systems to software vendors telling HMRC, and businesses and agents calling the VAT helpline. HMRC's stakeholders, particularly the professional bodies representing agents, have also been key in helping to identify and resolve issues. This resolution has included both changes to the service and improvements to guidance to make the process clearer.
- 3.2.9 To maximise their ability to resolve issues speedily HMRC created a dedicated central team to investigate and find solutions. Most issues were resolved quickly, meaning that the impact was limited. Learning from its experiences, HMRC will replicate this approach to handling live issues from the outset in the future.

- 3.2.10 Overall, the MTD VAT service has worked well for the vast majority of people joining and using it. However, HMRC does not underestimate the impact on the businesses and agents affected, particularly in cases where it was not possible to resolve the issue quickly. For example, HMRC could have acted more quickly to rectify the problem for the small number of businesses who filed for an incorrect period. In future phases of roll-out the longer pilot and dedicated central team should help to mitigate difficulties for customers.
- 3.2.11 Whilst a large proportion of businesses and agents have successfully transitioned to MTD without any issues, there were others who reported difficulties in the early stages, particularly in signing up to the service and choosing a software provider.
- 3.2.12 The main reason that tax agents experienced difficulties with the sign-up process for their clients was the need to first set up an ASA. This is a one-off process, so agents that set up their ASA when MTD for VAT was mandated will not need to repeat the process for MTD for ITSA. In addition to the improvements to its guidance and support during the pilot, HMRC has also been working with the professional bodies representing agents to address their concerns and identify improvements they would like to see to the design of the ASA. Some of these have now been implemented. For example, the creation of a 'dashboard' to allow agents to link straight through to services from their ASA and to sign-up a client to MTD. HMRC is considering options to make the process that agents have to complete to sign-up their clients simpler and quicker. The population of clients who will need to be signed up to Income Tax by agents is larger than for VAT, so HMRC is working to provide a solution that limits the burden on agents. HMRC will continue working closely with the agent community on the design of its services for the next phases of MTD to ensure that the lessons are learned from the roll-out of MTD for VAT.
- 3.2.13 HMRC has also responded to other types of requests from businesses. For example, businesses told HMRC that they would like reassurance that returns filed using MTD-compatible software had been received by HMRC. HMRC has improved its guidance to explain that although businesses will not receive email confirmation from HMRC when they submit a return, they can get this reassurance from their business tax account, which provides details of the returns submitted. Additionally, HMRC has worked with software developers to strengthen the confirmation messages played back via their software.
- 3.2.14 In response to customer feedback, and concerns about when they were likely to receive their repayments, in October 2019, HMRC delivered a repayment tracker for VAT customers. This provides information as to when customers should expect to receive their VAT repayment. There have been over 52,000 visits to the tracker since its launch in October.
- 3.2.15 At customers' request HMRC has re-introduced the ability for customers to view and print their VAT certificate and introduced functionality that allows customers to tell HMRC about their changes of circumstances online. This provides a convenient service for customers that they can access at a time suitable for them. Online change of circumstances functionality was only available to a limited population before MTD, so this is an improvement that the new digital service brings.

### 3.3 Communicating with businesses to raise awareness of their MTD obligations and help them prepare

- 3.3.1 HMRC commissioned research<sup>9</sup> (spring 2017) keen to understand the types of support and communications that would be most likely to have a positive appeal, impact and effectiveness in supporting businesses' transition to MTD.
- 3.3.2 Using the findings from this research, HMRC developed an integrated communications strategy that comprised a variety of channels: social media, stakeholder engagement, publications, videos, the GOV.UK website, media, direct customer correspondence, events and webinars.
- 3.3.3 HMRC's strategy for making sure that businesses knew about MTD and what they needed to do also included working closely with software developers, representative bodies and agents to support their publicity and communications. This reflects the fact that MTD involves businesses using third-party software, and many businesses prefer to go to an agent for information and guidance about tax. HMRC produced a 'partner pack' of basic information about MTD to support partners in communicating about the changes and ensure consistency of messaging.
- 3.3.4 To ensure every business required to join the new service was aware of the changes, HMRC wrote directly to each business within the scope of MTD. These letters were timed to arrive once these businesses were able to join the pilot as they would then be able to take action as a result. However, some businesses said they would have preferred direct communication from HMRC earlier. HMRC has listened to this and would plan to write earlier to those affected in any future mandated phases of MTD, giving businesses more time to prepare.
- 3.3.5 HMRC carried out four waves of research<sup>10</sup> between May 2018 and July 2019 to measure businesses current awareness, readiness and behaviours. It found that by July 2019:

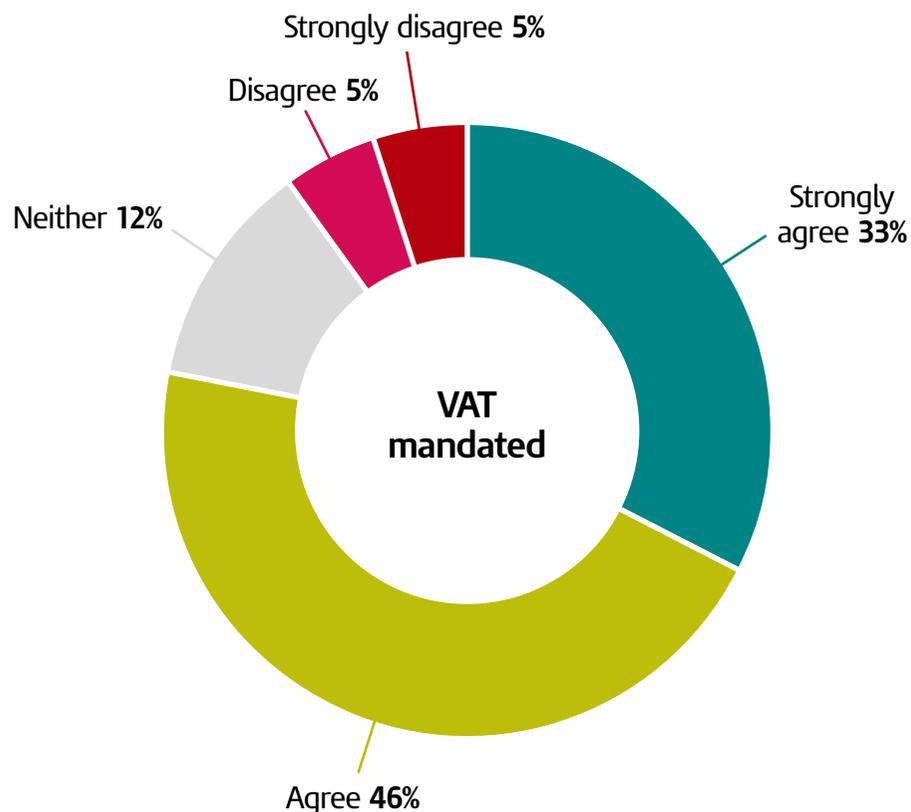
- 98% of VAT mandated businesses were aware of MTD by name or concept, compared to six in ten in May 2018.
- 91% of businesses who were aware of MTD had made preparations.
- Use of software or apps amongst VAT mandated businesses had increased, rising to 84%.
- 78% of mandated businesses agreed with the statement that they were comfortable using technology to manage business finances.



Figure 1: Awareness of MTD by name or concept among VAT mandated population (May 2018 to July 2019)

<sup>9</sup> Making Tax Digital: Exploring Transitional Support approaches – published May 2018

<sup>10</sup> [www.gov.uk/government/publications/monitoring-business-awareness-of-making-tax-digital](https://www.gov.uk/government/publications/monitoring-business-awareness-of-making-tax-digital)



**Figure 2: Level of agreement about use of technology to manage business finances among VAT mandated businesses: "I am comfortable using technology to manage business finances".**

3.3.6 In addition to HMRC's communications activities, many software developers raised awareness of MTD through extensive media campaigns which included billboards and TV and radio advertising. Representative bodies for businesses and agents also played a key role in communicating with their members about the changes and a number produced comprehensive guidance and support to help them prepare.

3.3.7 As well as guidance produced for GOV.UK, which HMRC iterated and improved in light of feedback from the pilot, HMRC's webinars have proved a popular source of information about MTD. More than 72 webinars have been delivered since January 2019 to more than 40,000 attendees with average satisfaction scores of around 76%. Half of the webinars were aimed directly at tax agents and tailored to their specific queries, while the rest were designed for the businesses required to join MTD. HMRC continually updated the content to include new information as it was released, and to address attendees' comments and questions.

### 3.4 HMRC readiness

3.4.1 HMRC put plans in place to manage its readiness to handle operational changes including ensuring staff had the right level of training, guidance and communications available to them at the right time.

3.4.2 HMRC has acknowledged that in May 2019 some customers had an unsatisfactory experience when calling its VAT helpline and has acted to address this.

3.4.3 HMRC doubled the number of people taking VAT helpline calls from 100 to more than 200 and trained nearly 100 extra contingency staff who could be deployed to match call peaks. HMRC also adopted a number of other strategies to address the waiting time experienced by its customers. These included:

- better automated messaging on the helpline to point callers to relevant website material;
- implemented intelligent telephone routing to direct callers to the right advisor who could answer their queries;
- providing live webinars;
- offering direct emails to callers who needed more basic information about VAT;

- sending emails to businesses who had not yet signed up to encourage them to do so and point them to the help and support available online;
- sharing information on some of the common reasons for contact with software developers and the professional bodies representing agents, so they could incorporate it into their own communications and guidance.

3.4.4 This action led to improved performance levels. An average wait of less than five minutes has been almost consistently achieved since June 2019, including the peak filing weeks in August, September and October. This was despite the inevitable demands in connection with businesses preparing for EU exit.

3.4.5 The valuable lessons learned in rolling out MTD for VAT will be a key starting point in shaping HMRC's approach to developing its communications and support offering for the next phases of MTD.

### 3.5 Choosing software

3.5.1 Under MTD, businesses and agents use MTD-compatible software to submit their returns. This draws the relevant VAT return data directly from their digital records. While record-keeping software has existed for some time (independently from MTD) a new market in MTD-compatible software has developed over the last 18 months.

3.5.2 The use of third-party software reflects HMRC's Application Programme Interface (API) first strategy<sup>11</sup>. MTD is the first major HMRC programme to adopt this strategy. It has led to the development of a vibrant and competitive market of third-party software products that can connect to HMRC's systems.

3.5.3 The software industry has produced a wide choice of more than 500 MTD-compatible software products for businesses looking to choose software. As at 5 March 2020, this included 13 free products (each

with its own terms and conditions), around 55 trade-specific software products and 13 accessible products (that meet cognitive, visual, hearing and motor needs). More than 250 subscription-based software products already being used by many small businesses were upgraded to MTD for free. The degree of choice available allows businesses and agents to choose a software solution tailored to their needs. Some stakeholders have expressed concern that they believe the cost of software is significantly higher than the government's estimate. The government's estimate is based solely on those costs and savings strictly related to meeting MTD tax obligations, and not what they may choose to spend. Many businesses may have chosen more expensive software because of additional features that provide them with other business benefits.

3.5.4 For many businesses, it is most effective to keep their digital records and submit their returns through a single, fully integrated software package. However, in response to feedback from the public consultation on MTD in 2016, HMRC amended the MTD requirements to allow businesses and agents the option to continue using spreadsheets to keep their digital records. To meet the requirements of MTD, these spreadsheet-based records need to be combined with bridging software that draws the necessary data from the spreadsheet digitally and submits it to HMRC. This has prompted the development of a significant market in bridging software - there are 185 bridging products available. Many of these bridging products can also be combined with bespoke, in-house record-keeping systems, or older software that has not been updated for MTD.

3.5.5 Some stakeholders have expressed fears that once the initial roll-out of MTD for VAT is complete, software developers will start to drive up the cost of MTD-compatible software. HMRC understands these concerns but expects that the market for software products will remain sufficiently competitive and will continue to provide a range of products that suit a variety of budgets and business needs.

<sup>11</sup> [www.gov.uk/government/publications/hmrc-third-party-tax-software-and-api-strategy](http://www.gov.uk/government/publications/hmrc-third-party-tax-software-and-api-strategy)

3.5.6 HMRC recognises that such a wide range of products makes it harder for businesses to identify the best option for their needs. This is particularly so for those not supported by an agent and, or those who have not used accounting software previously. Research<sup>12</sup> carried out in autumn 2019 found that, among the businesses we interviewed, some did not seem aware of free software options and their accountants did not have the digital skills to give advice on the most appropriate software. This led to these businesses purchasing bridging software, seeing it as a safer option than becoming fully compliant. This exacerbated feelings that the software was not meeting expectations or providing tangible benefits.

“I went for this one because my accountant recommended it, but she probably only did because it’s the one she knows how to use.”

(Business using bridging software)

3.5.7 To help businesses identify suitable MTD-compatible software, HMRC has published (and regularly updates) a list of MTD-compatible software on GOV.UK<sup>13</sup>, known as the MTD software choices page. This includes the ability to filter for particular features. HMRC recognises the need to continue to improve its guidance to help businesses, particularly small businesses that don’t use an agent, to identify the most suitable software product for them. HMRC also acknowledges that because it was only possible to add a filter for free software products at a late stage in the process, many businesses might have faced difficulties identifying free options when they chose their software. This filter will be available from the outset for future mandation cohorts. HMRC is continuing to look at options to further improve the software choices page, while developing supplementary guidance to help businesses understand what they should consider when choosing software.

3.5.8 There is always going to be a limit to the role HMRC can play in helping people choose software. That is why it is keen to encourage other stakeholders into helping with software decisions. Some third parties have already produced guides to help people choose software, but these are mainly targeted at agents. There could be a space for third parties to step into this market, like they have in many other industries, providing review aggregators or comparison tools.

3.5.9 HMRC worked closely with the large number of software developers who wanted to produce MTD-compatible products, to ensure they had what they needed. HMRC published technical documentation to enable software developers to build software that uses its MTD APIs, and a ‘Terms of use’ document to govern the relationship between those software developers and HMRC. Acting on ongoing feedback from developers, HMRC has made a number of improvements to its API documentation and sought to maximise the notice given of changes to its APIs. Looking ahead to the roll-out of further MTD services, HMRC also wants to involve developers in the design of HMRC’s APIs at an earlier stage and has already started to do this with MTD for Income Tax.

### **3.6 Volumes of businesses using the service**

3.6.1 The majority of businesses above the VAT threshold were required to join MTD for their first VAT period starting on or after 1 April 2019. The first mandatory filing deadline for the majority of businesses fell between 7 June and 7 October 2019 depending on whether a business files monthly or quarterly, and for quarterly filers, whether their first 3-month VAT period started in April (‘stagger one’), May (‘stagger two’) or June (‘stagger three’).

<sup>12</sup> [www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses](https://www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses)

<sup>13</sup> [www.tax.service.gov.uk/making-tax-digital-software?](https://www.tax.service.gov.uk/making-tax-digital-software?)

3.6.2 Figure 3 (below) shows the number of businesses mandated in each of these groups that had signed up over time. The turnover figure on the VAT return has been used to estimate the numbers of mandated customers. As well as taxable turnover, the figure on the VAT return will include VAT-exempt turnover and some out of scope turnover causing the number of mandated customers to be overestimated. This will mean the percentages of customers signed up will be underestimates of the level of compliance with joining and filing through MTD, as some of those businesses are not required to join MTD.

**Cumulative Mandated Number of Sign-ups and % by Stagger**

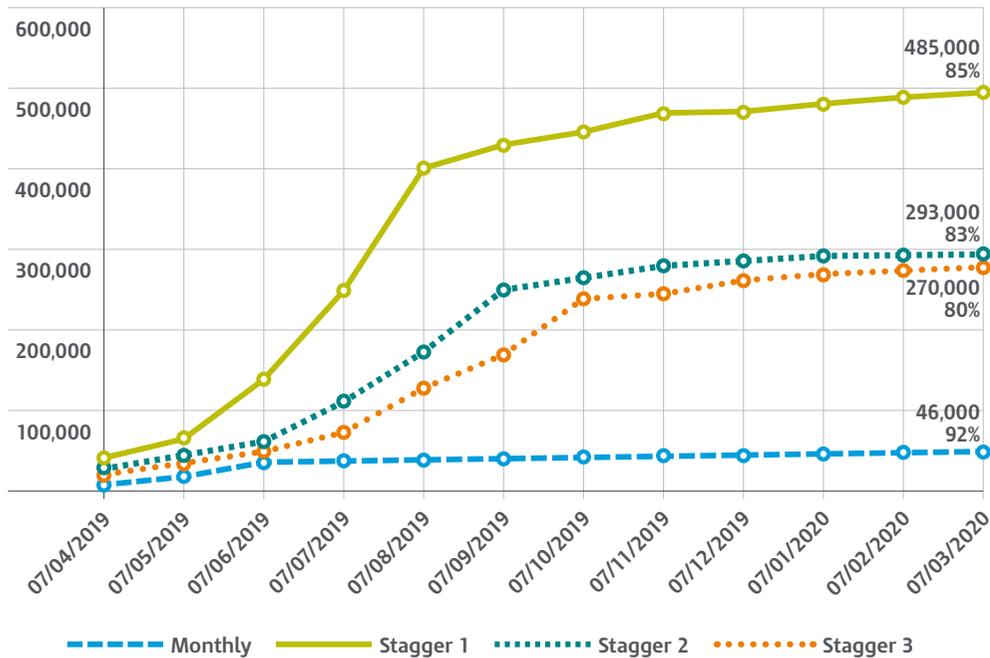


Figure 3

3.6.3 Figure 4 (below) shows the number of VAT returns that have been successfully submitted through MTD-compatible software. The biggest increases have happened since the first quarterly filers were due to submit their first returns through MTD (the period leading up to 7 August).

Compliance within the population signed up to MTD has been high, with around 95% of those in MTD who were due to file their returns by 7 August and 7 September and 7 October doing so on time.

**Total MTD ETMP Submissions (All Businesses)**

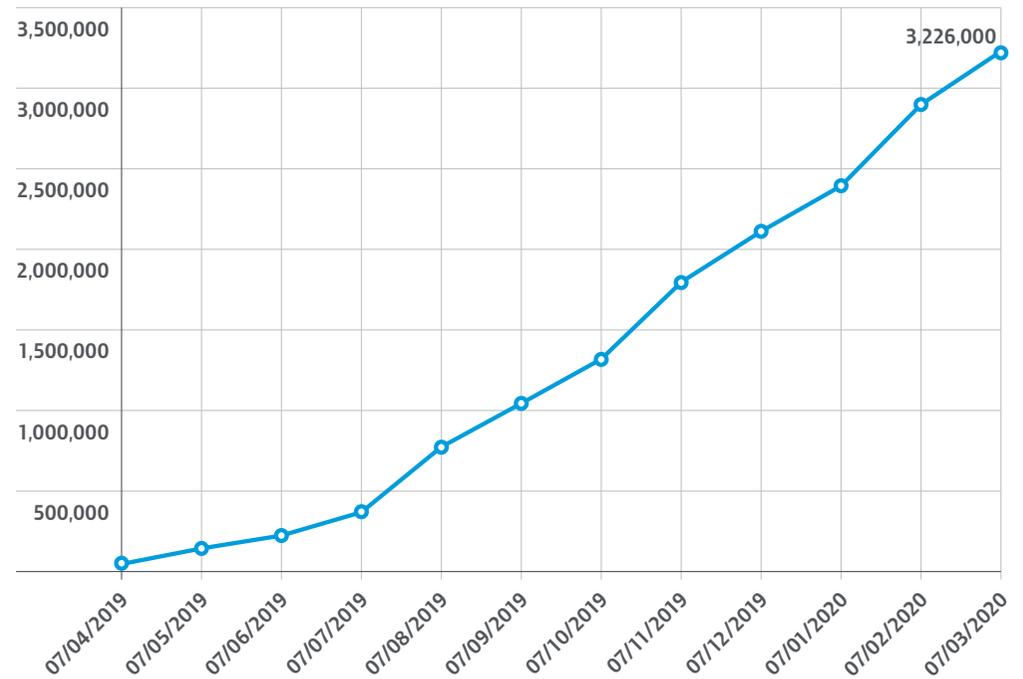


Figure 4

- 3.6.4 HMRC has been clear from the outset that it recognises moving to MTD is a significant change for many businesses and has been taking a light touch approach to digital filing and record-keeping penalties in the first year, as long as businesses had made genuine attempts to comply.
- 3.6.5 HMRC has written to businesses who have not signed up to MTD (and filed through MTD by their first deadline), to encourage them to join. The first businesses to receive such letters were monthly filers and there followed a significant increase in numbers signing up. HMRC therefore expects direct letters to have a similarly positive effect on customers in groups with later deadlines, where they have not signed up in time.

### **3.7 Accommodating digitally excluded businesses**

- 3.7.1 VAT-registered businesses have been required to file their VAT returns online since 2011. Those that were digitally excluded and unable to meet the requirements of online filing were able to apply for an exemption. The government has decided that this small minority of businesses would also be exempt from MTD for VAT, without needing to reapply. HMRC has therefore carried these exemptions across to the new service.
- 3.7.2 The government also recognised that a small minority of businesses whose VAT returns were previously being filed online through HMRC's VAT portal might not be able to meet the additional requirements of MTD. For example, an agent, friend or family member might have entered their VAT figures from their paper records into the VAT portal for them, but they might not be able to use a computer or smartphone to keep digital records. Therefore, HMRC has decided that

such customers would be able to apply for exemption from MTD and continue to file through the VAT portal. HMRC published guidance in February 2019 covering the type of customer who could apply for an exemption and how to apply. HMRC accepts it would have been better to have published this guidance earlier. To ensure this did not have an impact on the businesses concerned, HMRC has confirmed that businesses who had applied for exemption would not be required to join MTD, should their application fail, until they had received HMRC's decision.

- 3.7.3 This process has worked well. HMRC had received 2,876 valid applications for exemption by 17 January 2020, which was in line with its expectations. Of these applications, 80% met the criteria and were approved, while just under 20% failed to meet the criteria so were rejected. HMRC has not yet received any formal appeals against the decisions not to grant an exemption. In addition to valid applications, there were a significant number of applications that had to be returned for further information, or that did not require a new exemption. For example, because the business did not meet the criteria for mandation, or it was already exempt from online filing for VAT.
- 3.7.4 To give businesses clarity about whether or not they need to prepare for MTD HMRC will, for future phases, provide clear guidance on who can request exemption, and how, at an earlier stage.

### 3.8 Service Reliability

3.8.1 **Downtime on MTD Services:** Since the MTD VAT service went live in April 2019 there have been a small number of periods of unplanned downtime due to technical issues. In the main, these technical issues were not specific to MTD; rather they impacted a number of HMRC systems. When these incidents occurred, HMRC rapidly invoked contingency plans to minimise the potential impact on customers within the service. As well as rapid work to reinstate the services within a matter of hours, these have also included communications to inform customers of the problem and allow customers additional time if required to file their return (where downtime coincided with a filing deadline). Although there have been some technical issues, as to be expected with a transition of this size and complexity, the evidence shows the service is working as intended. Over 94% of returns due in January 2020 were received in time for January 2020's filing deadline, despite one of the temporary outtages falling on the day of the filing deadline.

3.8.2 HMRC has continued to investigate the issues and has identified a number of actions that need to be taken to further improve the overall performance and reliability of the services. For example, in the short term, HMRC has added additional server capacity and is working to stand up special support teams that will be online and monitoring the entire VAT services platform to ensure zero impact through the VAT submission period. A more fundamental IT upgrade by mid-2020 should help to secure a more permanent improvement in service reliability.

3.8.3 Several agents and businesses reported that at busy times the API didn't work. HMRC's analysis shows that there are no issues with the API, but that there are issues with those APIs being consumed/processed by HMRC's own internal systems. This appears to the business/agent as if HMRC hasn't received the submission. HMRC is, as a matter of urgency, enhancing and rebalancing systems to prevent this failure reoccurring. HMRC apologises for the inconvenience this has caused.

### 3.9 Customer experience

3.9.1 As set out in previous sections, HMRC has been monitoring the experiences of businesses and agents using the MTD for VAT service and using their feedback to improve the service. These experiences have also been key to refining HMRC's help and guidance to support a smooth transition to MTD for VAT.

3.9.2 To give customers a better experience, HMRC have made a number of improvements, including:

- Broadcast messages deployed on the VAT helpline to give clear signposting to online advice
- Improved specific online guidance to tackle the high volume calls about less complex issues
- Improved Software Developers' guidance to help them better assist their clients
- An outbound email to advisers that they could send on to customers who had general MTD enquiries. These gave links to a wide range of help and advice, including YouTube videos and webinars.
- Routing telephone calls to MTD skill groups who were trained in the high-volume call types, to allow the core MTD advisers to answer the more in-depth enquiries.

3.9.3 As more businesses joined the service, HMRC started to feature some of their experiences in case study videos (Appendix B) to provide context and reassurance to those who had not yet signed up. Although high level, the videos describe genuine businesses' experiences of making the change, particularly showing how easy some had found it to adopt MTD and the benefits they experienced from it. Appendix C also includes case studies, from a farming business professional and an estate agent, who describe their positive experiences with the transition to MTD for VAT.

3.9.4. As more businesses and agents transition to MTD, HMRC is starting to see more examples of how the shift to digital is delivering wider benefits. For example, a recent poll by Thomson Reuters at an online event indicated that<sup>14</sup>:

"...whilst many companies have only recently started filing under MTD for VAT, they have already acknowledged a number of benefits to being involved in the scheme.

"The study found that half (51%) of respondents reported having simplified or more efficient processes, with 32% saying they now have more accurate VAT returns. Additionally, 19% of companies said they also have better visibility of their tax liabilities thanks to the scheme."

3.9.5 HMRC commissioned qualitative research<sup>15</sup> to help understand the observed behavioural impact on record-keeping and the approach to making VAT submissions. For around  $\frac{3}{4}$  of the businesses interviewed, the processes they used before the introduction of MTD were generally highly manual and required intervention at both the record-keeping and calculating stages. MTD has seen an overall reduction in scope for error and a perceived improvement in accuracy when compared with previous methods.

Businesses using software packages (rather than bridging software) felt that they had been affected by the following:

- Input errors have been reduced. Digital linking and automation meant that data either only have to be input once or are automatically pulled onto software.
- Returns are more accurate, with everything fed into software daily. This made it easier to account for everything and include all records in a VAT return.

- Miscalculation errors were reduced, with figures calculated automatically via software.
- They were able to correct errors quickly and easily. This was because frequent input, automatic bank reconciliation and easy-to-use software meant they could manage finances daily and in real-time, making errors easier to spot and source.

3.9.6 One business who has made the switch to fully integrated software commented<sup>16</sup>.

"What's really great is I have complete control... It's empowered me and given me a greater understanding of how my business works."

Another business who made the switch said:

"I feel confident in the software that we're using... it's been a plus, as a company... because of the time we're saving."

3.9.7 On the other hand, the research<sup>17</sup> found that using bridging software had minimal impact on the scope for error. These businesses had consciously tried to make minimal changes to their record-keeping and accounting methods, using bridging software to link to their existing processes. They were frustrated by what they saw as an 'extra step' and were not clear why MTD had been introduced as they felt no benefit. Over time, these businesses may feel able to move to other software solutions which, as well as further driving down scope for error, will enable them to experience the wider benefits of MTD (such as time savings).

<sup>14</sup> [www.accountancytoday.co.uk/2019/09/03/32-of-tax-professionals-report-more-accurate-vat-returns-under-mtd/](http://www.accountancytoday.co.uk/2019/09/03/32-of-tax-professionals-report-more-accurate-vat-returns-under-mtd/)

<sup>15</sup> <sup>16</sup> <sup>17</sup> [www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses](http://www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses)

3.9.8 As more businesses make the transition to MTD and get used to the new service HMRC expects to see more examples of how the shift to digital is supporting these kinds of wider benefits. HMRC has also seen reports from businesses and agents who have had a less positive experience using MTD. HMRC has sought to address this and has detailed many of the changes that have been made as a result of feedback referenced in this document. HMRC will continue to listen to feedback to identify any further improvements it can make to the MTD for VAT service. HMRC will implement the lessons learned from MTD for VAT as it continues to design and build the MTD service for ITSA.

### **3.10 Review of the Making Tax Digital service for VAT: At a glance**

- Businesses with a taxable turnover over the VAT threshold (currently £85,000) were required to join MTD for their first VAT period starting on or after 1 April 2019.
- More than 1.4 million businesses have now signed up to MTD for VAT and more than 4 million VAT returns have been submitted through the service - in line with HMRC's forecasts.
- More than £41 billion payments have been processed through the new system and more than £13 billion repayments have been issued.
- Overall, the MTD VAT service has worked well for the majority of people joining and using it. Learning from this first phase will be applied to future plans.

- As a result of feedback from businesses and agents, HMRC has made a number of improvements and enhancements to the service including to the Agent Service Account, telephone service and guidance.
- There is a competitive software market with more than 500 products available including free and low-cost products.
- HMRC has taken a light touch approach to digital record-keeping and filing penalties in the first year to support businesses making the transition to MTD.
- HMRC does not underestimate the impact on the businesses and agents affected by the small number of early issues with the service, particularly in cases where it has not been possible to resolve these issues quickly. HMRC is carefully monitoring the transitional costs for businesses and evaluating MTD's impact in reducing error.
- HMRC is committed to working with stakeholders to ensure the lessons learned from the roll-out of MTD for VAT inform the next phases of MTD.

# 4 Update on the Making Tax Digital service for Income Tax

## 4.1 Introductions

4.1.1 Like MTD for VAT, MTD for Income Tax requires businesses and landlords to keep their records digitally and to submit their tax return directly from those records using MTD-compatible software. Instead of an annual Income Tax return businesses and landlords will be required to send HMRC a quarterly summary update of their business income and expenditure with a finalisation process at the end of the year. The quarterly updates are a straightforward summary of income and expenses - there is no requirement to make any accounting adjustments at that point. The software generates these summary updates, drawing from the data in the digital records the business or landlord has been keeping, allowing them to send it to HMRC at the click of a button. They will receive a view of their emerging tax position based on the information provided, helping them budget for their tax better throughout the year.

## 4.2 The MTD Income Tax pilot

4.2.1 A small-scale pilot of MTD for Income Tax commenced in April 2017 with a handful of invited sole traders, landlords and their agents participating. This allowed HMRC to test the sign-up and submission process with businesses and agents, in a live environment, before it moved into public beta trial in March 2018. The pilot remains on a small scale as both HMRC and the software industry have focused most of their efforts since then on the successful delivery of MTD for VAT.

4.2.2 There has been limited investment to date in MTD-compatible software products for Income Tax, with only six products currently listed on HMRC's software choices page. There are other products at various stages of development, but HMRC recognises that a concrete roadmap to mandation is necessary in order to stimulate the kind of vibrant market for MTD software that has developed for VAT.

4.2.3 HMRC has continued to develop and test the MTD Income Tax service on a small scale. This includes releasing further functionality to allow those in the pilot to finalise their Income Tax affairs at the end of the year and to give them the option to report other information alongside their trading or rental income, for example, bank interest.

4.2.4 As part of the pilot, HMRC has worked with businesses, agents and software providers to successfully prove that the end-to-end MTD Income Tax service works in a live setting. In addition to keeping their records digitally and sending their quarterly summary updates, a small number of businesses have now been able to meet their tax obligations entirely through software, without needing to complete a separate tax return. HMRC will continue to work with businesses, agents and software providers to improve the service and add more functionality.

## 4.3 Expanding the income tax pilot - applying the lessons from MTD for VAT

4.3.1 Following recently released additional functionality, more than one million sole traders and landlords are now eligible to volunteer for the MTD Income Tax pilot.

4.3.2 Even if businesses or landlords are not eligible to join the pilot, or do not want to join yet, they are encouraged to make the change to digital record-keeping sooner rather than later (if they don't already keep their records digitally), because this will be the biggest change for some. Many sole traders and landlords have established routines for managing their business records<sup>18</sup> meaning that the easiest time to switch to digital record-keeping could be the start of an accounting period, commonly April.

4.3.3 HMRC has already involved software developers in the design of the service and expanded the documentation available to support them.

<sup>18</sup> Making Tax Digital for Business: Survey of small businesses and landlords (November 2017) [assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/663182/Report\\_480\\_Making\\_Tax\\_Digital\\_for\\_Business\\_Survey\\_of\\_small\\_businesses\\_and\\_landlords.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/663182/Report_480_Making_Tax_Digital_for_Business_Survey_of_small_businesses_and_landlords.pdf)

- 4.3.4 HMRC expects a large, competitive software market including products that integrate both VAT and Income Tax. HMRC will work with software providers to produce a more informative software choices viewing guide, helping businesses select an MTD for Income Tax product that suits their needs and preferences, including identifying products that cater both for Income Tax and for VAT. Businesses should in future be able to choose a single product that allows them to easily create their business records digitally, and from those records automatically generate the updates required by HMRC for both VAT and ITSA. Some software providers currently operating software for MTD for VAT have already updated their products to include MTD for ITSA functionality.
- 4.3.5 To minimise costs for the smallest businesses, HMRC has committed to there being some free software products available. At least one free product is already available for MTD for Income Tax.
- 4.3.6 HMRC will also simplify the customer journey for joining MTD for Income Tax, implementing its learning from the MTD VAT service. More than 33,000 agents have already created an Agent Services Account and will not need to repeat this step to add clients for MTD for Income Tax.
- 4.3.7 HMRC will use the current GOV.UK content for MTD for VAT as a template for Income Tax content. There have been a number of iterations of the VAT content to ensure that it meets users' needs, for example, setting out the key steps for businesses and agents. This basic guidance will be augmented by a suite of other help and support products and events, including a programme of webinars for businesses, landlords and agents, which have proved very popular for VAT.
- 4.3.8 HMRC will also ensure that the full range of information that businesses currently report on an Income Tax Self-Assessment return can be reported under MTD for Income Tax. As functionality for each income type is added, more businesses will become eligible to join MTD for Income Tax.

#### **4.4 Update on the Making Tax Digital service for Income Tax: at a glance**

- A small-scale pilot of MTD for Income Tax began in April 2017.
- As part of the pilot, HMRC has worked with a small number of businesses, agents, and software providers to successfully prove that the end-to-end MTD Income Tax service works in a live setting.
- The first businesses in the service have now met their Income Tax obligations entirely through MTD. This means, as per the intended design for MTD, they have not needed to complete a separate tax return.
- More than one million sole traders and landlords are eligible to volunteer for the pilot.
- HMRC will work with software providers to produce a more informative software choices viewing guide, including identifying products that support both MTD for Income Tax and MTD for VAT.
- HMRC has committed to there being free software products available for the smallest businesses with straightforward affairs. There is already one free product available and more expected to come to market up to and during the pilot period.
- More than 33,000 agents have already created an Agent Services Account and will not need to repeat this step to on-board clients for MTD for Income Tax.

# 5 Conclusions and next steps

## 5 Conclusions and next steps

- 5.1 Following the roll-out of MTD for VAT, HMRC can draw significant confidence from its ability to deliver the required technical solutions needed for MTD and that a diverse and vibrant software market will develop to support it. Many questioned HMRC's ability to deliver the MTD VAT service in time to launch the pilot from April 2018 and mandation from April 2019. Although some would have liked to see the pilot opened up to its public phase sooner than October 2018, more than 90,000 businesses had signed up to MTD by the end of March 2019. The pilot was invaluable in identifying and resolving issues and improving guidance and support, as was continuing to monitor and develop the service as larger volumes started to use it. The pilot for ITSA will be much longer than that for VAT.
- 5.2 The lessons learned from the roll-out of MTD for VAT, many of which are referenced in this document, will be key to informing HMRC's approach to the next phases of MTD mandation. Alongside this, HMRC is committed to continuing to work closely with the software industry, the professional bodies representing agents and other business representative bodies. Their insight and input throughout the development of the VAT service has been invaluable, as has the work they have done to prepare their customers and members for the transition to MTD for VAT. Continuing to draw on their knowledge and expertise will be crucial to the success of the next phases of MTD.
- 5.3 In addition to this, HMRC continues to gather customer insight to help improve the MTD service. Early research<sup>19</sup> has shown that mandation of MTD has the potential to be a significant driver for the uptake of technology among businesses. For many MTD has merely been the catalyst for a business to consider its wider approach to technology and how it can harness it to drive profits and growth.
- 5.4 HMRC has commissioned external research to provide robust qualitative evidence about the ongoing costs and benefits experienced by businesses in their first year of mandation of MTD for VAT.
- 5.5 HMRC is also considering seeking businesses' views on whether MTD has:
- enabled them to better integrate their tax obligations with the wider running of their business
  - given them greater certainty around their financial situation by enabling them to have a more up-to-date view of their income and expenditure and, subsequently, their tax position.
- 5.6 Broadening MTD to include other taxes will bring new obligations and new costs as well as new benefits. The experience of implementing MTD for VAT will help HMRC evaluate the cost to business of further roll-out of MTD. For the current VAT population, the sole ongoing steady state cost is for software subscription.
- 5.7 Through its compliance activity, HMRC will continue to follow up those businesses it expected to start using MTD for VAT, but who have not yet joined. It will also seek to ensure that businesses in MTD are operating MTD correctly. For example, by April 2020 businesses that still have manual links between software in their process to generate their VAT return, will need to replace these with digital links.
- 5.8 The launch of MTD for VAT in April 2019 was the beginning of an ambitious programme to transform the way businesses, and the agents who represent them, interact with the tax system. The roll-out of MTD for VAT was an important step in this transformation. Starting with VAT made sense as the existing obligations on businesses matched the MTD requirements quite closely. However, to unlock the full benefits of going digital, the next stages - extending MTD to more businesses and other taxes - will be key.

<sup>19</sup> [www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses](http://www.gov.uk/government/publications/evaluating-making-tax-digital-impact-on-record-keeping-behaviour-and-scope-for-error-amongst-small-businesses)

# Appendix A

## Key facts and figures on MTD for VAT

- A.1 First phase of MTD mandation applies to VAT registered businesses above the £85,000 threshold (1.2 million). They are required to join for VAT periods starting on or after 1 April 2019.
- A.2 Businesses below the VAT threshold (0.9 million businesses) can join voluntarily. More than 270,000 have done so, as of March 2020.
- A.3 More than 98% of all VAT returns were already being filed online.
- A.4 More than 1.4 million businesses have now signed up to use MTD for VAT, as of 9 March 2020. This rate of progress is in line with HMRC's forecasts.
- A.5 The following table shows the number and proportion of mandated businesses that have complied with the requirement to join MTD (a) by their first deadline, (b) by 9 March 2020.

Note that the percentage figures will be an underestimate of compliance, because HMRC's population figures will include some businesses who do not, in fact, have taxable turnover above the threshold for mandation.

### Non-deferred businesses signed up to MTD

Population mandated to join MTD for VAT	First MTD filing deadline	Number of businesses signed up by first MTD filing deadline	% mandated businesses signed up by first filing deadline	% mandated business signed up by 9 March 2020
Monthly filers	7 June	32,000	70%	[92%]
Stagger 1	7 August	370,000	74%	[86%]
Stagger 2	7 September	230,000	72%	[83%]
Stagger 3	7 October	219,000	72%	[81%]
<b>Total</b>				[84%]

- A.6 The MTD VAT service has worked well with 90% of problems being resolved in a matter of weeks.
- A.7 There is a competitive software market with more than 500 products available including free and low-cost products.
- A.8 There are 185 bridging products available which will allow businesses and agents to continue using spreadsheets, their in-house record-keeping systems or older software not updated for MTD, to keep their digital records.

Type	Number	Attendees	Average attendees
Agent	36	17,929	498
Business	36	22,146	615
<b>Total</b>	72	40,075	563

- A.9 Webinars secured an average satisfaction score of around 76%.
- A.10 8 out of 10 VAT mandated business were aware of MTD by early December 2018, which was six months or more before the date they needed to submit their first return through MTD.
- A.11 The mandation of MTD for VAT is currently forecast to deliver a reduction in the tax gap leading to additional tax revenue (ATR) of £1.2 billion by 2023 to 2024, with steady state savings of around £300 million per annum.

# Appendix B

## YouTube videos

- B.1 An accountant in Hull  
[www.youtube.com/watch?v=KC\\_D9VH5qPU](https://www.youtube.com/watch?v=KC_D9VH5qPU)
- B.2 An accountant in Orkney  
[www.youtube.com/watch?v=v-PRJUkM6IM](https://www.youtube.com/watch?v=v-PRJUkM6IM)
- B.3 A butcher in Dorset  
[www.youtube.com/watch?v=XOfRI7M76no](https://www.youtube.com/watch?v=XOfRI7M76no)
- B.4 A florist in Orkney  
[www.youtube.com/watch?v=qa2TU03tMxk](https://www.youtube.com/watch?v=qa2TU03tMxk)
- B.5 A teashop in Orkney  
[www.youtube.com/watch?v=9\\_j8B15KDZE](https://www.youtube.com/watch?v=9_j8B15KDZE)

In the MTD Orkney videos, businesses commented on their experiences:

“In terms of cost, it’s minimal, it’s not been prohibitive at all. It’s been great going from paper to digital. Previously it would take hours manually editing and making returns to now having it all at the click of a button. Going digital has made an immense difference to the amount of time that I have free. More time to put into making cakes, spending time with customers and being able to plan staffing and other elements of the business that normally would be done at midnight’.

“Accounting software helps to do the VAT submission online. It lets me see right away, very quickly, how much VAT I have to pay and how much I’m getting back, rather than having to think about signing papers and having to wait for things to come back. It’s all there right away, I’m not getting any surprises or shocks.”

# Appendix C

## Case Study 1: F Ives, Farm Secretary – Making Tax Digital (MTD)

Fiona Ives is a self-employed rural business professional (Farm Secretary) based near Basingstoke. Fiona previously lived and worked on a Dairy Farm and she now shares her expertise and experience with other farming businesses. Fiona told us about her experience of Making Tax Digital for VAT.

"I have helped many farms move from manual (or excel spreadsheets) to digital records and they're all getting on fantastically well with it. I think it's fair to say most people would have been reluctant to make the change to digital but I'm sure most of them would now say it's been a really positive change. I am a member of the local branch of The Institute of Agricultural Secretaries and Administrators Ltd (IAgSA) and we had a few training sessions before the MTD deadline, people were concerned how it was going to all work.

However, MTD for VAT has been nothing but straightforward. As a Farm Secretary all of my clients were already using accounts software. It just took loading the programme update, following the MTD set-up wizard, and onto the HMRC website to apply to sign-up for MTD. Within a very short space of time I had a message from HMRC to say I had the go ahead. So back into the accounts software, and I set it up ready for MTD. Then at the end of the first MTD VAT Return (having done my usual checks through the figures) I pressed the button and off went the VAT Return. It went through very smoothly indeed - no finding my login details, no waiting for the text message with the code, no entering the figures and checking and double-checking they were correctly entered, and no finding my login details again to go back in for confirmation! Straightaway I had confirmation it had gone through and a receipt back from HMRC.

What had I been worried about? It was so straightforward, quick and reassuring! I have also set up an arable farm on the software who had until then been doing their accounts manually - the whole process could not have been easier. From manual to computerised accounts might seem like a bit of a leap, but I hope other farms have found it as positive an experience as my clients have. It's obviously been essential for MTD VAT, but having computerised accounts brings so many other benefits to the business - for the farmer, their accountant and their book-keeper!"

## Case Study 2: D Denis, Downen Estate Agents – Making Tax Digital (MTD)

Downen Estate Agents is a business based in the North East of England. It has 8 branches covering the mid North East from the coast to the A1 corridor. It was founded in 1982 by Managing Director Denis Downen. Denis shared with us his experience of Making Tax Digital for VAT:

"When I first learned that Making Tax Digital was becoming mandatory for businesses above the VAT threshold - I admit I was sceptical. As a business dealing in property sales, purchases, auctions and property management there are a great deal of transactions to track from a VAT perspective, and I certainly did not want the process to become overly complicated.

However, I learned more about MTD for VAT via the .GOV website and I spoke to my Accountant. I soon realised that as we already kept many financial records digitally - signing up to MTD and submitting via MTD or VAT was the next natural step for us. I found the process relatively straight forward and it did not take long to become business as usual across the business.

MTD also acted as a catalyst for the expansion of our digital . Having been in business almost 40 years we did have considerable paper-based records. However, we moved more and more of these to a digital basis and saw many immediate benefits. Not just the instant accessibility of records across our branches, but also the time it freed up for colleagues as they accessed records easily and immediately. At the end of the day anything that frees up resource so our staff can focus all of their time on providing a five-star service to our customers is very welcome in my book."