HM Revenue & Customs

Bringing business tax into the digital age

Summary of responses
31 January 2017

Contents

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Foreword

We live in the digital age. New technology is continually transforming the way people and businesses shop, bank, travel, communicate, and trade. Increasingly, people are interacting with government digitally too, but the services we've been able to provide have not kept pace with people's expectations.

Around two million small businesses, landlords and the self-employed already use software to manage their affairs. Many are already using apps to regularly record their income and expenses. And so far this year, more than seven million people (around 87%) have filed their Self-Assessment digitally, up from just 39,000 (0.5%) when it was first introduced in 2000.

The tax system should make it easier for businesses to get their tax right first time. The latest tax gap figures show that too many businesses are prone to making mistakes with over £8 billion a year in tax lost from avoidable taxpayer errors. This not only costs the public purse – it also causes businesses cost, uncertainty and worry when HMRC is forced to look into their affairs.

Making Tax Digital will tackle these challenges. It will help businesses steer clear of errors, get their tax bills right and give them a clearer view of their tax position in-year. I recognise that this will be a change for many businesses. But the Government is committed to delivering this change in a way which is responsive to the diverse needs of the business community.

Of course, there will be cases where going digital is either more difficult or not feasible, and we recognise that. To ease that burden, we have committed to ensuring that free software is available for a number of small businesses. And we have consulted extensively to make sure we have a good understanding of the small number of businesses for whom digital is genuinely not an option - due to geography, personal disability or other circumstances. HM Revenue and Customs will ensure that there are alternatives for those who genuinely need it.

However, for the majority I believe that Making Tax Digital will transform the way businesses, landlords and the self-employed interact with the tax system for the better, by providing clarity and certainty over their tax affairs throughout the year and making it easier for them to get their tax right first time.

As most consultation responses acknowledged, a digital tax system is a logical step in an increasingly digital world. The feedback, evidence and contributions we have received throughout the consultation period, alongside the extensive live testing we will begin from April, will help us to deliver this change in a way that works for businesses. I would therefore like to take the opportunity to thank everyone who put time and effort into responding to this consultation, and look forward to further constructive conversations in the future.

Jane Ellison

1. Introduction

Background

1. Making Tax Digital (MTD) is a key part of the government's initiative to transform HM Revenue and Customs (HMRC) into a world-leading, digital tax authority, reducing the burden for individuals and businesses to keep on top of their tax affairs, with digital tax accounts meaning the end of the annual tax return for millions.

2. The majority of businesses want to get their tax right but the recent tax gap figures (HMRC, Measuring Tax Gaps 2016[1]) show too many find this hard. The amount of tax not collected due to taxpayer error and carelessness has risen to over £8bn a year. This not only costs the public purse, it also increases businesses' cost, uncertainty and worry, particularly when HMRC is forced to intervene to put things right.

3. HMRC needs to do more to help businesses get their tax right up front rather than tackling them once things have gone wrong. That will reduce the likelihood of errors, lowering the chance of unwelcome compliance checks and giving businesses greater certainty.

4. Making Tax Digital for Business (MTDfB) is an important step in that direction. The introduction of digital record keeping and quarterly updates for the majority of businesses will take out around 10% of error, and lay the foundations to go further with digital nudges and prompts to help improve voluntary compliance. It will also give businesses a clearer view of their tax position in-year. The government strongly believes this will enable small businesses, in particular, to meet their tax obligations at minimum cost and minimum disruption. HMRC expects MTDfB to bring in around £2bn by 2021-22.

5. MTDfB will also bring the tax system into line with what businesses and individuals expect from other online service providers: a modern digital experience. The internet was used daily or almost daily by 82% of adults (41.8 million) in Great Britain in 2016, and 70% of adults accessed the internet 'on the go' (away from home or work) using a mobile phone or smartphone, portable computer or handheld device.[2] Online banking, shopping and interaction is commonplace, and social media is used for a wide range of purposes.

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/561312/HMRC-measuring-tax-gaps-2016.pdf

[2] ONS Statistical bulletin: Internet access – households and individuals: 2016 https://www.ons.gov.uk/peoplepopulationandcommunity/householdcharacteristics/homeinternetandsocialmediausage/bulletins/internetaccesshouseholdsandindividuals/2016#main-points

6. Last year more than one million small businesses accessed digital help and support from HMRC. The appetite for digital services is strong, and carrying on with paper-based processes makes no sense in the 21st century.

7. The government believes that, for the majority of businesses, the transition to the new system will be straightforward because they already use digital tools on a regular basis, for instance, online banking, and and/or keeping their records digitally and sending HMRC data quarterly, for example, Value Added Tax (VAT) returns. However, the government recognises that MTDfB represents a significant change for some, and HMRC is committed to delivering these changes in a way that works for businesses and those who represent them.

Details of the consultation

8. The consultation *Making Tax Digital: Bringing business tax into the digital age* was published on 15 August 2016 and ran until 7 November 2016. It was one of six consultation documents published on that date, each focusing on specific customer groups or elements of the MTDfB reforms. A short guide to the six consultations, containing some of the key questions from each consultation document, was published at the same time.

9. The consultation looked at how digital record keeping and quarterly updates would work in practice. We received formal responses from a broad spectrum of stakeholders, especially businesses, including the self-employed, and landlords, as well as agents, trade and professional (tax/accountancy) representative bodies, software developers and insolvency practitioners.

10. The consultation focused on each element of meeting the new obligations: acquiring digital tools, digital record keeping, making quarterly updates to HMRC and finalising the income tax position at the end of each year. It also considered which businesses and landlords should be exempt from these obligations and made an initial assessment of the impacts on customers of the reforms.

11. The consultation also provided an opportunity to confirm that the digitally excluded[3] will be completely exempted from the MTDfB obligations; and consider the case for financial support to help some businesses make the transition to MTDfB and what form this should take.

How people responded

12. HMRC received 618 written responses from individuals (including businesses) (153), accountants (264), representative bodies (40) and others (161). Some of the individuals and accountants represented wider organisations but were classified as individuals because they were replying in a personal capacity. A list of respondents to the consultation, excluding individuals, is contained at Annex A. In addition, around 1,200 respondents completed an online survey linked to the short guide to the six MTD consultation documents (see paragraph

[3] See government response to question 34 for definition of "digitally excluded"

8 above), which included some of the key questions from this consultation, the responses to which are included in this summary of responses.

13. HMRC also provided other opportunities for stakeholders to express their views. During the course of the consultation period, HMRC held a number of events with interested parties to communicate and discuss the proposals, including: 25 face-to-face ‘roundtable’ meetings with 370 people in total attendance; 13 public webinars and 2 ‘Talking Points’ webinars for agents, which attracted over 2,000 participants. They also took part in a wide range of externally run conferences and events to reach as wide a group of stakeholders as possible. Feedback from these events has been considered as part of the consultation exercise.

14. The government wishes to thank those who responded to the consultation and recognises the time and effort that went into the comments and contributions received. These have informed the development of the policy and draft legislation.

2. Responses

1. This section summarises the responses received during the consultation generally, and specifically in relation to each of the questions raised and the reforms and processes that were consulted upon under the heading of 'Bringing business tax into the digital age'.

General comments

2. Respondents welcomed the opportunity to comment on the detail of the proposals in *Making Tax Digital: Bringing business tax into the digital age*, and the majority were supportive of the move to a digital tax system, to include the introduction of simple, secure and personalised digital tax accounts.

3. However, respondents did raise concerns about the pace of change and the capability of the smallest businesses to adapt, as well as those who struggle with digital technology. Some also felt that the core MTDfB requirements could result in more late submission penalties being levied regardless of what penalty model was adopted.

4. Many respondents advocated the need for agents to have full access to digital tax accounts to enable them to support customers in complying with requirements.

5. Respondents were also keen to understand issues around data security (for instance, sensitive information being stolen whilst using third party software), and access to data when changing software supplier.

6. These points are addressed in the detailed responses contained in this document.

Government response to general comments

The government welcomes the confirmation that a digital approach is right, and acknowledges the different views received in relation to many of the issues raised in the consultation document, in particular the start date for MTDfB and the groups that should be exempted. The key decisions are:

- businesses will be able to continue to use spreadsheets for record keeping, but they must ensure that their spreadsheet meets the necessary requirements of MTDfB. This is likely to involve combining the spreadsheet with software
- businesses eligible for three line accounts will be able to submit a quarterly update with only three lines of data (income, expenses and profit)
- free software will be available to businesses with the most straightforward affairs

- the requirement to keep digital records does not mean that you have to make and store invoices and receipts digitally
- activity at the end of the year must be concluded and sent either by ten months after the last day of the period of account or 31 January, whichever of these is soonest
- charities (but not their trading subsidiaries) will not need to keep digital records
- for partnerships with a turnover above £10 million, MTDfB is deferred until 2020 due to the complexity of their tax affairs

The MTD consultations also specifically explored the appropriate level of the initial exemption and deferral for the self-employed, landlords and businesses who will be in scope. Given the range of views expressed on this matter from respondents to the consultation, the government will take more time to consider these issues alongside the fiscal impacts. Final decisions will be made before legislation is laid later this year.

In addition to the written responses, the Treasury Select Committee published a report into MTDfB. The consultation decisions address many of the Committee's recommendations, including recognising the importance of thoroughly piloting the changes before implementation. HMRC will begin piloting digital record keeping and quarterly updates for a full year from April 2017, building up to working with hundreds of thousands of businesses and landlords before rolling the services out more widely. This will ensure the software is user-friendly and give individuals and businesses time to prepare and adapt.

HMRC has also published an updated impact assessment. Some respondents claimed MTD could cost thousands per business. The impact assessment outlines that there will be a significantly smaller one-off transitional cost of £280 per business, on average, followed by small ongoing annual savings. This is in addition to the benefit of having a clearer in-year view of your tax position and removing uncertainty and the worry of HMRC interventions.

Chapter 2. Acquiring Digital Tools

1. This chapter of the consultation document considered the practical changes required to move from the current record keeping and filing requirements, to record keeping using digital tools and providing quarterly updates to HMRC. It addressed what HMRC meant by "digital tools", how businesses would choose the right product for them and the guidance and support that HMRC would provide. This included ensuring the availability of free products for those businesses with the most straightforward affairs.

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?

There were 239 responses to this question.

2. Respondents suggested that the challenges included adjusting to using digital record keeping and potential for errors, data security, internet access in rural areas, potential agent fees and a lack of support.

3. Respondents suggested that the move away from the use of customised spreadsheets for record keeping would be a challenge to business both in terms of monetary cost and time, and felt that the added functionality in software products could add complexity for those businesses whose size and nature did not warrant it, and pointed out the familiarity and ease of use.

4. However, a few respondents outlined that software suppliers had solved the issue of storing and recording transactions digitally. They felt that spreadsheets should not be considered as 'digital records' because they do not offer the extended options (such as error checking) required for modern record keeping and business management.

5. Other respondents thought that where businesses and landlords have not previously maintained their records digitally, they should have a longer period to adjust to the requirements of MTDfB. Respondents thought it was important for HMRC to promote clearly the benefits of both accurate and regular record keeping.

Government response

6. The government notes the variety of responses received and is committed to delivering these changes in a way that works for all involved, which is why these changes are being extensively piloted during 2017, before phasing in from April 2018. The use of paper records is declining and more and more businesses transact online with banks, customers and suppliers. Individuals and businesses are demonstrating a strong appetite for HMRC's digital services. For example, more than seven million people have used the Personal Tax Account, more than one million small businesses accessed HMRC's digital

help and support last year, millions of taxpayers have renewed their tax credits online or claimed a tax repayment and 9.23 million (89%) Self Assessment returns were filed online in 2014-15.

7. The government will provide for spreadsheets to be used for data capture, to record receipts and expenditure, as part of MTDfB. A business choosing to keep their records in this way will need to ensure that their chosen spreadsheet functionality is able to meet all the necessary requirements of MTDfB (keeping digital records, providing quarterly summary information updates and the end of year activity). This is likely to involve combining the spreadsheet with software in some way, and HMRC will also test this process during the pilot.

8. The government recognises that businesses will require access to the internet in order to transmit data to HMRC and upgrade their software. 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. As part of the 2016 Autumn Statement, the government announced new funding of £1 billion to boost the UK's digital infrastructure; this will prioritise faster connections for businesses. In addition, the government will introduce a legal entitlement to free basic digital skills training for everyone in England aged 19 and above who does not have a relevant digital skills qualification. Further detail regarding training and support can be found in response to question 5.

9. HMRC will continue to work with a wide range of stakeholders to raise awareness of MTDfB amongst businesses, helping them prepare for the changes. The government recognises that agents will be important partners in supporting the delivery of the MTDfB changes, as will software developers. HMRC is working with software developers to ensure that there is a good choice of products, and has emphasised the need to allow agents to continue to work in collaboration with the taxpayer and have access to the software the business uses (with the permission of the business). This would allow the current collaborative relationship – where agents already have access to third party software that the business uses – to continue.

10. Security aspects are dealt with in detail in the government response to question 6.

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

There were 84 responses to this question.

11. Many respondents said that there needed to be an easy, unbiased process by which to identify the software that would suit the needs of the business, including information such as cost, functionality, and operating system compatibility. There were mixed views as to whether HMRC or agents should provide this advice. In addition, there were requests for free training, through

methods such as face-to-face workshops, as well as tutorials and online help pages.

12. As some business owners will need support to learn how to use software, respondents suggested it would be appropriate for this advice and support to be funded by HMRC. It was felt that standardised product measures would help business owners in their choices. A few respondents suggested setting up user groups to provide mutual support and share software user reviews. Some respondents suggested that an online chat facility could be offered.

Government response

13. HMRC is working closely with the software industry to ensure secure and effective MTDfB-compatible software is available. HMRC intends to provide guidance to businesses in choosing the software that is best suited to their particular needs. It proposes publishing a register on GOV.UK, confirming which applications are registered with HMRC and are MTDfB-compatible, along with details of the software, in good time for the start of MTDfB in 2018.

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

There were 125 responses to this question.

14. Responses ranged from every business having access to free software, through to free software only being available for all businesses up to the VAT registration threshold, to no businesses having access to free software.

15. Some respondents felt that there should be assurances that the product would remain free while it was in use including for updates and carrying out the minimum requirements of MTDfB. In addition to the highest security features to protect confidential data (including secure storage), respondents gave a wide range of functions they would like to see in free software, based on a simple, user-friendly format in plain English. Requests for functionality included:
    - basic cash and bank movements
    - the ability to raise simple invoices
    - some form of general ledger
    - the ability to apportion costs
    - back-up, import and export of data
    - ability to scan receipts
    - easy categorisation of expenses
    - questions and prompts to ensure correct completion of data fields
    - the ability to accept direct feeds from the business bank account
    - the ability to upload comma separated values files ((.csv), which allows data to be saved in a table-structured format) or equivalent existing files
    - ability to send self-employment income details to Department for Work and Pensions

16. Respondents expressed concern that the free software market could shrink or disappear once MTDfB beds in and whether there was sufficient safeguards of

quality of free software. Some respondents assumed that free products would only carry a basic functionality, including only catering for standard VAT accounting.

17. Some, however, argued that any free software product should be minimal in functionality and only accessible for the most basic of businesses, only meeting the basic MTDfB requirements of capturing income and expenditure and allowing this to be uploaded. Ideally, the software would include prompts and nudges to minimise incorrect input of data, for instance, whether expenses are allowable or not. Some respondents suggested that the checklists used in existing HMRC toolkits would be a good starting point.

18. A few respondents thought that there would be some implied cost associated with a reportedly free product, whether that be for 'add-ons' or additional features of the software. Respondents asked whether software developers might charge for secure storage of data.

19. Respondents also suggested that:

- the free software would only be written to cater for sterling, so small exporting businesses that were eligible for free software should be given financial grants to purchase potentially more expensive, multi-currency, upgrades

- as many businesses would be currently using some form of spreadsheets, it would be helpful to use that format as a starting point for free software

- there should be some form of compensation from HMRC if a free software error leads to significant financial detriment or severe operational disruption to business.

Government response

20. The government has already committed to free software being available to those businesses with the most straightforward affairs. HMRC's working assumption is that these businesses are generally those who are smallest in size and least complex, and that largely, these businesses are likely to be those that are unincorporated, under the VAT threshold, and have no employees. Those over the VAT threshold (£83,000) are more likely to be larger, and already have an obligation to provide quarterly information to HMRC (and so likely to use some type of software).

21. HMRC is currently working with software developers to define the minimum functionality of a free software package that would meet MTDfB requirements. HMRC proposes, as a minimum, that free software would allow businesses to keep digital records, generate and send quarterly updates to HMRC and complete end of year activity to ensure compliance with MTDfB requirements. It would also have arithmetical error correction, some basic level of built-in prompts and nudges, basic help functions, and be able to send information from HMRC to businesses about their tax liability. Given the working

assumption referred to above, there would be no requirement to include any functionality relating to VAT, corporation tax, or Pay As You Earn. It is important to emphasise that these are HMRC's recommendations for minimum functionality for free software, which we would expect developers to meet, as the industry has accepted the need for free software. Software developers are of course able to offer further functionality through free software if they wish to do so.

22. HMRC expects that there will be a wide variety of paid-for software packages as well as a number of free products that will reflect the different requirements of businesses. HMRC is working closely with the industry to ensure the development of a wide range of products at different price points, including free software offerings. HMRC is pleased that, in the main, the industry accepts the need to ensure the availability of free products, and expects these products to remain so (i.e. no payment required at all through the life of the product), including any support and updates for the product while it is in use. HMRC will share the suggestions put forward in response to this question with software developers, on an anonymised basis, to inform their work in building software packages. As part of this commitment, the government plans to promote and monitor the take-up of free software, to ensure eligible businesses are, firstly, aware of these products, and secondly, are able to readily access them.

23. The issue of spreadsheets has been addressed in the response to question 1, and testing of products and security are addressed in the government's response to question 6.

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?

There were 150 responses to this question.

24. A wide variety of options was offered in response to this question, ranging from £1,000 to £30,000 for 'one-off costs' and between £100 and £1,000 per year for running costs. Some respondents believed that because the government is mandating MTDfB, it should be responsible for all associated costs, including training; others felt that there should be no recourse to public funds. Some respondents suggested that there should be some form of incentive through either tax credits, redeemable vouchers, a tax deduction, enhanced capital allowances or non-taxable grants. Nevertheless, it was recognised this should be targeted at smaller businesses and monitored to ensure that public money was not being abused.

25. Some respondents believed that any financial support should be adequate to enable the business owner to receive appropriate training and acquire extra IT equipment as necessary. Some suggested that if the exemption threshold rises, the range of those needing help might also expand. Others thought that

additional tax relief should be considered to cover training costs for the first 24 months of MTDfB, or from the start of a new business.

26. Some respondents suggested that there might be an extended phasing-in period which offered a fixed sum deduction from tax, for example, £500 technology deduction, which would apply to businesses below, say, the cash accounting level.

27. Alternative suggestions included offering an integrated financial package of support, including low cost digital skills training, plus affordable broadband options being made available and promoted.

Government response

The government has provided a combined response to questions 4 and 5.

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

There were 115 responses to this question.

28. Other forms of support that would help make the transition to MTDfB easier included:
    - face-to-face seminars and tutorials
    - dedicated, free, HMRC telephone helplines, open from 8am to 8pm
    - expert advice provided free of charge
    - group training sessions provided by HMRC, for those without digital skills
    - user-friendly printed manuals, as well as a “welcome” pack containing information about MTDfB and signposting places to go to for help
    - guaranteed broadband speed and reliability
    - clear and simple communication, including information forums.

29. Agent respondents felt that they also needed help and training about the future requirements of MTDfB, in order to support business owners.

30. Several respondents pointed to the Australian Tax Office programme of engagement, which included workshops, videos and newsletters, to engage with and educate the business community about MTDfB. Another suggestion was that HMRC should provide some form of accredited training. In addition, some suggested that HMRC should consider providing a stand-alone website that would not only raise the profile of MTDfB, but also assist businesses in choosing products and services.

Government response

31. The government recognises that it is essential businesses get the help and support they need to make MTDfB successful for them. Over 1 million small businesses accessed digital help and support from HMRC last year and HMRC will build on this to ensure that the right help is available in a range of ways and through a range of channels to ensure it meets the diverse needs of the business and agent populations. In particular, help needs to be targeted at

those businesses that have the most need of it. HMRC will carefully consider the suggestions made, and final decisions will be made before legislation is laid later this year.

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

There were 70 responses to this question.

32. The majority of respondents who answered this question concentrated their replies on security aspects. Although respondents were satisfied with the current levels of security and methods of authorisation when dealing with HMRC, they felt that it was important that HMRC had good security mechanisms in place (including encryption) under MTDfB. Respondents wanted assurances about robust security testing and that information could not be 'hacked'. It was also noted that HMRC systems should be able to cope with any large influx of data through quarterly updates.

33. In terms of Government Gateway registration, respondents asked for a simplified form of access. They felt that this would make it easier for business owners to enrol for MTDfB, and free internet access would encourage use of software. Some respondents reported that rollout of faster broadband, especially in rural areas, would be most helpful. Others felt that longer hours in which to contact HMRC would be beneficial. It was important that there were clear responsibilities as to which organisation is responsible for providing assistance to businesses at each point in the digital journey.

34. Respondents asked that free, high quality impartial advice be made available before business owners made their choice of software. Respondents felt that if they knew the software was "bug-free" that would give confidence in making choices. However, if a package was found to be ultimately not suitable, there should be the ability to change software packages. There was concern that software systems would not provide a backup record of accounts for businesses for the legally required six years.

Government response

35. The government agrees that the security of online tax services for all must be strong. The government is committed to implementing an approach that gives taxpayers confidence in the security of their data and that has no negative impact on their ability to meet their tax obligations.

36. Data security is one of HMRC's top priorities, and data communication conforms to the highest security standards. All data will be sent to HMRC via a secured system that will comply with strict security protocols that have been developed with Government Digital Service (GDS), Communications-Electronics Security Group (which sits within GCHQ), and security specialists.

37. HMRC and software suppliers will provide secure and effective products via an Application Programming Interface (API) platform that is always encrypted. Each API is extensively tested in accordance with established GDS criteria and standards to ensure that they are not only "bug-free" but also meet industry standard security specification - OAuth 2.0 - that captures best security practices. In order to ensure that taxpayer information is not made available to attackers, use of HTTPS[4] (which encrypts requests) is mandatory. In doing this, HMRC works closely with internal risk assessors and security advisers.

38. HMRC adheres to the highest standards of quality assurance to ensure APIs work as expected in multiple environments. Testers perform exploratory testing to emulate real user behaviour to ensure APIs are bug free and performs as expected.

39. HMRC has a dedicated cyber security centre to assess and counter risks to information security. Additionally, to avoid phishing attacks, HMRC vets the names of applications that are presented to taxpayers, so that applications claiming to be HMRC or known organisations are not able to acquire taxpayer data. HMRC has a range of guidance on GOV.UK to help customers and agents stay safe online: https://www.gov.uk/topic/dealing-with-hmrc/phishing-scams

40. Additionally, there are a number of ways businesses can protect themselves from a loss of important data and cybercrime. Free expert information for individuals and businesses can be found on the internet at Get Safe Online, a public / private sector partnership supported by the government and leading organisations in banking, retail, internet security and other sectors: https://www.getsafeonline.org/

41. HMRC will publish further details on these areas early in 2017 as part of a wider set of documents setting out the working relationship between HMRC and the software industry.

42. With regards to concerns raised by businesses about using a cloud-storage software package, HMRC anticipates that there will be a variety of packages available, to include desktop as well as cloud-storage products. With this information, the business owner will be able to select a product with a storage method that suits them.

43. Turning to Government Gateway registration, this is a one-off activity (unless the business changes software provider), and once complete businesses will be asked to authenticate their software with HMRC and the software will then receive a security token. Once authenticated, and when the business connects with HMRC using the software, they will only need to re-submit their credentials and undertake the two-step verification process if the security token has expired (after 4 hours).

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[4] HTTPS : Hypertext Transfer Protocol Secure; uses separate protocols called SSL (Secure Sockets Layer) and TLS (Transport Layer Security) to transfer data or information over the internet in a secure format

44. Software providers are being asked to build in the ability to export and import all of a customer’s records from one package to another, without loss of data, so that if a customer chooses to change software package they can do so and take their records with them. Software providers are also being asked to store the information in line with existing legal obligations.

45. Where there is an issue in using the software, HMRC considers the vendor should be the first point of contact. They will then assess whether the issue is software-based or tax-based. With regards to agents accessing client data, HMRC expects that software developers will build third party access into packages, depending on the level of sophistication. This functionality may also allow an agent to carry out the tasks that are required of the taxpayer (so act on their client’s behalf).

46. HMRC intends to undertake further research to refine customer needs in relation to helping businesses identify a suitable software package. In early 2017, HMRC will publish further details, including the security measures it expects software developers to build into the packages they will offer to enable taxpayers to meet their obligations under MTDfB.

Chapter 3. Digital Record Keeping

1. This chapter considered how businesses would keep digital records of trading and transactions and categorise their expenses with help from prompts and guidance from their software.

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

There were 117 responses to this question.

2. Many respondents felt that if software is simple and relatively quick to use, capturing a digital record should be straightforward and that keeping digital evidence should greatly reduce the risk of receipts and invoices being lost. A number expressed concern over the quality of scanned and photographed images, particularly if the original documentation was of poor physical quality.

3. Whilst many appreciated the reduced need to retain paper copies, there was some apprehension about scanning transactions and the amount of data storage needed – with possible increased data plan charges. Some respondents thought that paper copies should be kept to guard against fraud, to aid consumer rights and as protection against device failure or if the software provider ceases to trade.

4. Other potential issues in respect of digital record keeping raised included: lack or loss of access to hardware and internet, data integrity and security, data ownership and non-standardised invoicing making it difficult to extract the relevant data.

5. It was acknowledged that there could be a problematic transition for businesses presently keeping paper records. However, other respondents noted that paper receipts and records are easily lost, damaged or misplaced.

Government response

6. The government recognises the concerns expressed. With this in mind, the new requirement to keep digital records will not include an obligation to make and store images of invoices and receipts digitally. Businesses will be able to make use of this method where it is convenient for them, but there will be no requirement for them to do so, and will be able to keep digital or paper copies of transaction evidence as suits them.

7. The government accepts the concerns about the ownership and preservation of digital records, particularly where such records are stored in the cloud, and is working with software providers to ensure that businesses retain ownership and access to their records for the required retention period.

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

There were 79 responses to this question.

8. The majority of those who responded to this question agreed with the suggested minimum transaction fields and many provided ideas for other fields for the record keeping software.

9. These suggestions included:
   - reference and secondary reference (where a transaction is both internal and external)
   - details of customers and / or suppliers
   - date, type (cash / card / bank transfer) and amounts total
   - VAT code (if applicable)
   - a facility to “batch” low-value receipts for petty cash items under a certain total
   - a field to indicate currency of the transaction
   - stock movement
   - a free text field for a narrative to provide detail of expenses

10. The fields were considered suitable for business-to-business transactions. However, concerns were raised about the suggested fields for retail, construction and services sector where transactions are often paid by cash and the customer does not want an invoice.

11. Some respondents disagreed with all or part of the proposed minimum data fields. For instance, some felt that the proposal for the “deducted amount / percentage for expenses”, should be allowed on a monthly or quarterly basis.

12. Some respondents felt that HMRC should not become involved in this area as there were already adequate guidelines for keeping accounts, and software developers should be able to ascertain what businesses would need in terms of data capture.

Government response

13. The government welcomes the broad support on its proposals for minimum transaction data fields. It has examined the ideas for further data fields for the record keeping software, but considers that keeping the number of mandatory fields to a minimum is preferable whilst recognising that software vendors can and will provide many optional fields tailored to particular business sectors and circumstances.

14. The government understands that there are situations where a customer has no need to take an invoice and/or pays cash. These circumstances do not change the date on which a transaction should be accounted for; this will depend on whether a business is using cash accounting (date of payment) or accruals accounting (date of transaction). The use of software will improve

accuracy and timeliness of business records, eliminating the chances of transposition and arithmetic errors and increasing the certainty businesses have over their tax liabilities. The requirement for a transaction date field in the digital records is essential for these purposes and will therefore be retained.

15. For retailers, the government's approach is for an optional relaxation whereby retailers can digitally record their daily takings instead of itemising every single transaction.

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

There were 60 responses to this question.

16. Some respondents thought it would make sense for the MTDfB and VAT systems to be integrated to avoid unnecessary duplication and administrative burden for both parties. The majority of respondents believed that recording of transactions by all VAT registered businesses should be in line with the current VAT requirement. Some respondents suggested that complexity of software may result in businesses opting out of filing their VAT returns via software and choose to complete HMRC's online VAT return instead. However, other respondents reported that their existing software packages adequately captured all the necessary details.

17. For any software to satisfy both VAT and income tax purposes, respondents felt that alignment would be needed in terms of: minimum requirements for transaction recording/coding; reporting periods (the same quarter end dates for MTDfB and VAT); and an ability to correct errors from previous update periods. The software should cater for international transactions, and record retention dates need to be aligned. A number of respondents noted how complex VAT can be, and understood that translating this into software may be difficult.

18. Some respondents felt that certain VAT schemes, such as the flat rate scheme, are more aligned to the MTDfB proposals than others, and suggested that the opportunities for integration. Others found it difficult to understand how the different accounting periods for VAT and MTDfB would interact, for example, if the business had different accounting and VAT quarters.

19. Some respondents felt that if two separate systems were used for income tax and VAT under MTDfB, errors would still be likely to occur as businesses might find it hard to keep track of when and how they should make updates, plus any corrections.

Government response

20. The government understands the concerns about translating complex VAT requirements into software and the challenge of ensuring all possible schemes and circumstances are catered for. The government has no current plans to mandate the maintenance of VAT scheme or partial exemption calculations in

the digital software. Businesses will be able to choose how to make their VAT scheme calculations (for example in a spreadsheet or on paper) and enter the necessary adjustments directly into their MTDfB software's VAT Account.

21. VAT registered businesses will already be keeping the transaction data fields required for income tax purposes so the VAT data fields entries required in the digital record will build on this requirement. They will include the VAT value and the VAT rate elements of transactions. VAT registered businesses may opt to extend their VAT dataset, to include a breakdown of individual transactions by VAT rate where more than one rate is applicable to goods and services. The optional data will make prompts and nudges more helpful. VAT retailers who keep a record of their daily gross takings will now have to do so digitally. VAT cash accounting scheme users will digitally record the same dates of payment and receipt that they do now.

22. The VAT Account is an existing requirement of VAT law which every VAT registered business must keep. Under MTDfB this record will need to be maintained digitally in the software which will compile it from the transaction records.

23. Further data fields for VAT transactions may be required by particular businesses to generate an accurate VAT return (for example foreign currency value or prompt payment discount data fields). The existing requirement for an accurate VAT Account and VAT return will ensure that businesses have included the necessary data in their records.

24. The government believes that integrating software for VAT and income tax will often be possible for businesses, and is working with software vendors on developing this functionality.

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

There were 79 responses to this question.

25. Many respondents recognised that property is a complex area, remarking that more data capture fields would be needed to be able to cope with the varied scenarios that currently exist. Examples include:
    - UK and overseas income
    - joint and solely-owned property
    - value of property when first let
    - details of tenants' deposits
    - type of letting arrangement (furnished holiday lettings versus rent-a-room arrangement; furnished / unfurnished; residential or commercial lettings)

26. It would also be essential to identify capital items not allowable for income tax purposes but which will in due course be allowed for capital gains tax (for undertaking improvements).

27. Respondents felt the proposed analysis of rental income was too complicated with the reasons for separating income between properties unclear. Clarity was also sought on how the allocation of items that applied to all properties would be treated, particularly in regards to expenses not attributable to just one property, (such as, accountancy fees) and for consolidated loans against all properties in a portfolio.

28. Agent respondents reported that it is often very difficult to reflect correctly capital gains on a business return without agent intervention or detailed workings. Providing details may be particularly difficult where the property had been inherited or acquired as a gift. They also remarked that there were other issues to take into account, for example:

- the nature of the asset; assets used partly for business and personal purposes;
- assets where the deemed purchase price per unit changes over time (blue chip shares)
- disposals deemed to be at market value
- deferred consideration arrangements
- where Entrepreneur's Relief does (or might) apply

29. Because of the scope to report capital gains incorrectly, it was suggested that this aspect of reporting be made optional and deferred to the end of year activity. It was also suggested that it would be helpful if a calculator could be built into the software to calculate the gain and the tax liability based on information already uploaded.

Government response

30. The government recognises the concerns that respondents have raised in connection with proposals to require property income and expenditure data be attributable to individual properties. The government confirms the only requirement (as regards multiple properties within one property business) will be to maintain property address details of each property in the digital record. Income and expenditure data can therefore be maintained in the software at the level of the property business as a whole rather than at the level of individual properties.

31. So that businesses do not have to consider determining business from private gains in-year, the government agrees that calculating capital gains through the MTDfB software should be optional and deferred until the end of year.

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

There were 88 responses to this question.

32. Many respondents thought that the categories shown in the Self Assessment form would be sufficient as a starting point for most businesses. Any further sub-categories (for instance, a split between motor expenses and travel costs, and a category for digital/website/broadband costs) could be provided by

software packages for optional use and analysis of business performance, to suit the diversity and different levels of sophistication in existing business structures. Some respondents suggested that there should be “free text” boxes throughout the software that would help businesses provide descriptions relating to transactions.

33. There was recognition that these types of enhancements might only be available in the more expensive products, which very small businesses may not be able to afford.

Government response

34. The government welcomes the broad support for its proposals. The mandatory categorisations in the digital records of the transaction entries will be based on the existing Self Assessment categories. Any additional, more detailed, sub-categories in the record keeping software should be optional and provided by software providers to meet particular business requirements.

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

There were 67 responses to this question.

35. Respondents expressed a range of views. Some suggested that categories and sub-categories should be included within the software to record disallowances, whilst others thought there should be software options to determine disallowable percentages on monthly and quarterly basis, or to use a fixed percentage that is adjusted as part of the end of year activity by the agent.

36. Respondents noted that the complex nature of whether items are deductible often involves judgements and, more often than not, businesses - especially the smallest - would defer to their agent for a decision. The majority of respondents preferred the option of leaving disallowances to professional advisers at year-end.

37. Alternatively, respondents suggested the software users set up specific accounts for non-deductible elements, although the smallest businesses may still struggle to correctly input data without advice. Another option was that where expenses included a non-deductible element, this should be identified by the coding applied at the point of recording the transaction.

38. The software should be designed for the business to identify the categories that have non-deductible elements, with a default disallowance for each category specified when the package is set up. The business should have the option to override the disallowance with a specific adjustment when the transaction is recorded. A further suggestion was that there should be a facility to be able to enter private use against expenses and for this to be changed when appropriate - probably at the end of year. Some respondents identified that this would be an area where prompts and nudges would be valuable.

Government response

39. The government will facilitate respondents' desire to retain, as far as possible, flexibility around how and when to make judgements about the extent to which expenditure items are deductible for tax purposes.

40. When the transaction record is captured, businesses should have the option of recording the private or non-deductible element there and then; aided by software prompts and nudges. This will enable businesses to form a better picture of their in-year tax position and will also reduce the amount of work required at the end of year; even if more complex items are left until later, or for professional advice.

41. In order for each transaction item to contain a record of the non-deductible element the government will specify that the software digital record has the necessary data field. The business can choose to make the adjustment at any time up to the end of year.

42. The software could enable businesses to set defaults for particular expense categories in advance; for example the proportion of deductible home office expenses could be set as a percentage at the start of the year and reviewed subsequently; enabling those businesses that wish to, to defer some or all decisions to their agents. This also broadly reflects what unincorporated businesses do now when completing a Self Assessment return.

43. Many respondents suggested that this was an area where prompts and nudges could be very useful in helping people understand their tax affairs. HMRC plans to work with the software and accountancy bodies in the coming months to develop this area further.

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

There were 103 responses to this question.

44. There was a broad range of responses to this question, ranging from full support with suggestions as to what the prompts and nudges should be, to disagreement that any automated messages should be included within the MTDfB software.

45. Where respondents felt prompts and nudges should be included, these should be consistent across packages. Suggestions for prompts and nudges, in order to minimise common errors, included:
    - identifying possible transposition errors, VAT rate discrepancies and large variations to usual transactions
    - potential claims to make, such as loss relief
    - identifying unreconciled items where they have not been reconciled after a certain number of days (and a similar prompt for unpaid debtors and creditors would be useful)
    - lists of disallowable items and business vs personal use
    - capital vs revenue expenses

- prompts on nearing the VAT threshold

46. Some respondents preferred to see users referred to HMRC guidance for the most basic questions and suggested that general checks should be written into prompts and nudges, such as:
    - whether all income has been recorded;
    - whether all non-purchase business payments have been included (wages, insurance, water rates, rents, etc.)

47. Suggestions were also made about reminders being sent by text message or email of due dates for quarterly updates. Whilst the value in prompts and nudges was recognised by many as an effective validation tool for transposition errors and missing information, potential risks were identified in more complex areas. The ability to turn off prompts and nudges was also considered to be important.

48. Respondents suggested that most businesses will want to complete their quarterly updates and end of year activity correctly, and so would continue to seek professional advice, rather than rely on software.

Government response

49. The government acknowledges that many respondents were broadly supportive of the valuable contribution that prompts and nudges can play to help businesses get their tax affairs right. HMRC is working with both the accountancy and the software industry to provide nudges and prompts that are helpful to businesses and will ensure extensive user testing to make these messages as helpful as possible to users and effective in their outcomes.

Chapter 4. Establishing Taxable Profit

1. This chapter considered how MTDfB would help businesses establish their taxable profit. In particular, it explored when businesses should record accounting and tax adjustments for the purposes of arriving at a taxable profit and how they should reflect reliefs and allowances.

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

There were 88 responses to this question.

2. The vast majority of respondents agreed with the proposal that businesses should be able to choose when to record accounting adjustments, with most believing that a sensible time to make any adjustments is at the year end. A minority considered that the proposal moves away from Generally Accepted Accounting Practice (GAAP).

3. Many respondents felt that small businesses should be able to record income and expenses as they happen in the quarter. Most respondents agreed that where accounting adjustments were not made on a quarterly basis, the quarterly update would be less accurate.

4. Respondents also pointed out that allowing businesses to choose when to record accounting adjustments could mean more complexity through choice.

Government response

5. The government still considers that the right approach is for businesses to have flexibility as to when they should make any accounting adjustments, provided these are made no later than when a business must finalise its end of year activity. This balances the wishes of those businesses that prefer to include accounting adjustments as part of their update to HMRC against the concerns of those that consider doing so would offer little benefit.

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

There were 67 responses to this question.

6. The vast majority of respondents believed that businesses should have flexibility to record the effect of reliefs and allowances. However, they recognised that most businesses would use the year-end process. This would allow businesses to take advice from agents where appropriate as this was when the entire profit and loss situation for the period could be reviewed. However, respondents felt it should be possible for businesses, especially those making voluntary payments, to undertake quarterly reconciliations.

7. Some respondents asked for further clarity about how MTDfB would fit in with the ability of certain groups, such as farmers and authors to average their

profits over more than one tax year. Similarly, some questioned how losses would be dealt with under MTDfB.

Government response

8. The government accepts the importance of providing all businesses with the ability to see the effect of reliefs and allowances on their estimated tax position, whilst retaining the option to do this annually. The consultation is clear that businesses will not make formal claims to any relief or allowance as part of their quarterly updates. Businesses will continue to need to make a decision on whether to make an actual claim as part of their end of year activity. This will include the ability to make elections, such as averaging profits and making loss relief claims.

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

There were 103 responses to this question.

9. Respondent views on this question were varied, ranging from inclusion of the allowance at the start of the year to the allowance being taken into account only at the year end. Respondents flagged that there are different circumstances to consider so the Personal Tax Accounts (PTA) and Business Tax Accounts (BTA) will need to be linked.

10. Where respondents suggested allocating the personal allowance at the start of the year, they focused on how the software should display the information. For instance, the software could query if there were any other sources of income to ensure the allowance was not double-counted, and being able to apply the basic allowance, or automatically reduce it, once profits are estimated to exceed £100,000.

11. Views were mixed as to whether the personal allowance should be reflected in the tax calculations evenly through the year or if there should be choice as to how the personal allowance is allocated remarked that different businesses would take different views. Some felt that the personal allowance should be reflected at the point the taxpayer chooses to pay their tax; for those who opted to pay quarterly, respondents felt it was reasonable that a quarter of the taxpayer's personal allowance is taken into account.

12. A number of respondents suggested that the entitlement to personal allowance should be recognised at the end of year process, when all income is known and the final adjustments have been made as part of the end of year activity.

13. Some respondents felt that the personal allowance should not be included as part of the quarterly update process and should only be included in the taxpayer's PTA. Some were concerned about how the software would handle where a taxpayer has a reduced personal allowance.

14. Respondents also questioned how multiple income streams would be dealt with, as well as how personal allowances that are reduced gradually to nil for taxpayers over £100,000 would be administered.

Government response

15. The government recognises the wide range of views expressed in response to this question. Many views related to the impact of “non-business” income on the personal allowance for example where the personal allowance was applied against a separate source via PAYE. HMRC systems will be able to reconcile where an individual in business also has other income such as PAYE income and ensure that any in-year tax estimate reflects this. In view of this, the government considers that the best approach is to make the appropriate amount of personal allowance that is ‘unused’ available when a business makes its update to HMRC. The government will ensure that this functionality is fully tested in time for April 2018.

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

There were 27 responses to this question.

16. Respondents agreed that the approach taken in the consultation document was adequate for the simplest of partnerships, but could not be used for more complex partnerships, primarily due to complex profit sharing arrangements. Partnerships would need the ability to amend profit sharing details. Mixed partnerships, where there is a corporate member, were a further complication and consideration would have to be given as to how information will be fed through into the digital tax account for the individual taxpayer or the corporate partner.

17. Some respondents agreed that focusing on the partnership for reporting removed a significant layer of administration. However, respondents felt that the confidentiality for all partners would need to be protected. Respondents also noted that partnership agreements would need to be updated to reflect the proposed changes within MTDfB, and that this would likely incur costs.

18. Respondents posed a number of questions about the role of the nominated partner. Respondents also queried how personal expenses of partners would be dealt with and how the quarterly partnership update would feed into VAT return requirements.

Government response

19. The government recognises the need to maintain the confidentiality of individual taxpayers. There is no intention that the partnership (or the nominated partner) would be able to access details of each partner’s personal tax affairs. In respect of the issues which could arise with more complex profit sharing arrangements, the government believes that these can be overcome by making the ‘pushing’ of update information in year to partners’ digital tax

accounts an optional feature of MTDfB. Partnerships would be able to take advantage of this functionality should they choose, but there would be no requirement for them to do so. However, partnerships will be obliged to ‘push’ each partner’s share of any profits (or losses) through to their digital tax accounts as part of the end of year activity.

20. The government will legislate to provide a model for nominating partners which closely mirrors the existing requirement to nominate a partner to make partnership returns. This will include provision for HMRC to nominate a partner where a partnership chooses not to do so.

21. The government does not consider that it has any role to play in resolving any disputes which arise within a partnership. The government already has an established position in relation to how partners’ expenses should be reflected within the partnership and that is not impacted by this consultation.

22. The government will legislate to require partnerships to record and report all sources of income under MTDfB. This will include income from trade, property, savings and investments and miscellaneous sources. Partnerships will also report details of disposals of capital assets. This is because the government considers that, unlike individuals in business who may also have personal income, all the income a partnership receives arises from business activities and should therefore be reported through MTDfB.

23. The government recognises that the largest partnerships face issues similar to equivalent incorporated businesses, in addition to having more complex profit distribution and sharing arrangements than smaller partnerships.

24. The government has already confirmed that it will consider separately how MTD should operate for the most complex, incorporated businesses. Based upon the responses to the consultation, it is appropriate to consider the largest partnerships at the same time as the most complex, incorporated businesses.

25. To enable this, the government will defer the introduction of MTDfB for those partnerships with a turnover above £10 million until 2020. This is the level at which HMRC would no longer define a partnerships as a “small business”. This deferral will only apply to the income tax obligations under MTDfB. Large partnerships will still report VAT through Making Tax Digital from 2019.

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

There were 154 responses to this question.

26. This question prompted a mixed reaction, with many disagreeing that this would result in accurate quarterly updates.

27. Some respondents felt that the proposal probably reflected existing practice in terms of the management of jointly-owned property, and pre-populating data

fields would greatly reduce the work involved to report shared property income. They believed that the ability to alter the allocation between individuals either during the year, or as part of end of year activity, should be retained for maximum flexibility. As for the proposal to have a nominated owner who would be responsible for MTDfB processes, many respondents thought that this would work, on the understanding that each individual owner should have a digital tax account and they should be responsible for their own tax affairs.

28. Respondents who disagreed suggested that each individual who received income from jointly held properties should report that income separately. This was partly due to concerns about confidentiality relating to an individual's income, and partly due to the possibility of incorrect or inaccurate reporting of that income. Respondents felt that it was important that all parties agreed any figures submitted. A number of examples were provided to demonstrate where joint reporting would not be appropriate.

Government response

29. The government notes the range of views provided and as a result has reconsidered whether it is necessary to legislate to deliver this design. The wide range of issues and concerns raised mean that legislation to support an optional alternative basis of record keeping for jointly let property is unnecessary and could create further difficulties and complications. The government will therefore not legislate to provide for this approach.

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?

There were 106 responses to this question.

30. Generally respondents welcomed the proposal to use a contractor's CIS return to feed directly into a subcontractor's digital tax account, and where the subcontractor is unincorporated, an automatic population of their account should be possible. They remarked that automatic updating would vastly improve the subcontractor's knowledge of their tax position.

31. Respondents cautioned that the success of this route would be dependent on the contractor making a correct return initially. Some respondents qualified their agreement by saying that the proposal would be acceptable as long as sub-contractors could correct any data.

32. However, the agreement to the approach was not without concerns. A variety of issues such as interim refunds and claims for additional expenses were raised. Respondents flagged that many subcontractors have private, non-CIS work, and even employment, in addition to a CIS income. This potentially means that they will need to check both personal and business digital tax accounts.

33. Respondents asked whether a sub-contractor would be able to make an in-year refund claim. It would also be beneficial for software to provide “nudges and prompts” for all entries under “subcontractors” to ask whether these might fall within CIS.

Government response

34. The government notes the range of views expressed on this proposal and their recognition that this is the correct ambition for subcontractors. It was always the government's intention that subcontractors would maintain business records and provide updates to HMRC using MTDfB compatible software. This recognises the varied sources of income which subcontractors receive and the likelihood of them having business expenditure. However, the concerns raised regarding the pre-population of digital tax accounts means that the government will need to further consider the use of this information alongside other sources of third party information. As a result this functionality will not be available for the commencement of MTDfB in April 2018 and so in the interim, subcontractors will need to record and report the information of earnings and tax paid through CIS in their MTD compatible software.

Chapter 5. Providing HMRC with updates

1. This chapter considered how businesses, the self-employed and landlords would provide HMRC with quarterly updates under MTDfB. In particular, it considered the level of detail the updates must contain, the time periods the updates cover and when they should be submitted.

2. Our view remains that, with digital tools, most businesses will find updating HMRC in this way will be a light-touch process and more easily integrated into day to day business activity.

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?

There were 122 responses to this question.

3. Respondents considered that the level of detail required here should be no more than was required for completing and filing existing tax returns. Many respondents commented that businesses trading below the VAT threshold should not be required to report any more detail than is currently necessary. Others suggested that the level of detail required in an update could increase with the size of the business.

4. However, some respondents also acknowledged that there was merit in the proposal to mirror the income and expense categories contained in the Self Assessment tax return. It was accepted by these respondents that most software packages will automatically formulate expenses into these categories at the point they are entered so there should not be any reason for a lesser level of detail in updates. Others thought that most businesses, regardless of size, will be using very similar products so the level of detail will likely be very similar across the board.

5. Some respondents took the view that the less detail that was required, the less likely it would be that errors would enter the system, given that many small businesses are poor at consistent categorisation of expenses. These respondents saw no benefit to the business of greater categorisation, and only nominal benefit to HMRC.

6. Others noted that the categories of expenditure that will in practice be included in an update will vary greatly between different businesses. One respondent thought that only total income, total expenditure and professional fees are likely to be common categories across the board.

7. A majority of respondents thought that the present three line account option offered to businesses with turnover below the VAT threshold (total turnover, total expenses and profit / (loss) for the year) would be an appropriate dataset for MTDfB updates. Others suggested tailoring the update data requirements to the current VAT requirements.

8. A number of respondents questioned the requirement to provide any sort of in-year update. Concern was expressed over the proportionality of the requirement. Perceived burdens from more frequent updating were also raised, while some felt that quarterly updates would seldom be accurate.

Government Response

9. The government recognises the desire of respondents to keep the level of detail to a minimum and it has therefore based the data requirement in the quarterly updates on the existing categories in the Self Assessment form.

10. With all businesses categorising their transactions in the software, the easiest method of updating HMRC will be to submit a detailed (i.e. categorised) update. However, this will be voluntary for those businesses that are currently eligible for three line accounts so if they do not want to submit additional information they will be able to prepare an update that contains only three lines of data (income, expenses and profit).

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

There were 86 responses to this question.

11. The general view of respondents was that the categorisation of the summary data should be kept as simple as possible. It was suggested that the level of detail should be the same for all businesses otherwise HMRC risks disadvantaging particular businesses, or giving unfair advantages to one type of business over another.

    Respondents also questioned whether updates that only included income tax were viable, with the conclusion that if the intention is to make one digitally integrated system then VAT and income tax must both be included. It was observed that any applicable VAT scheme calculations must be calculated before the income tax calculations are performed, therefore a system that only included the income tax would provide no benefit.

12. The issue of burdens also arose in respect of categorisation and VAT, with the assertion that MTDfB would increase the amount of administration a small business using the VAT flat rate scheme would have to do. On this basis, it was asserted that quarterly updates would go against the premise that MTDfB would simplify the tax system and make reporting a quicker and less burdensome task to undertake.

Government Response

13. The government proposes that for income tax updates (subject to the retention of three line account updates for those eligible – see question 20 above) the level of detail for unincorporated businesses should be based on the current system of categorisation in the Self Assessment return which breaks down

expenses into categories such as, for example, car and van expenses; accountancy and professional fees.

14. VAT registered businesses using the VAT flat rate scheme should already be keeping an accurate record of their income and expenditure for income tax purposes, and as the flat rate scheme simply allows those businesses to apply flat rate percentages to their VAT inclusive turnover the government does not believe any special rules on capturing and categorising transactions for income tax purposes is appropriate for these businesses. Businesses eligible to use the VAT flat rate scheme to apply a flat rate to their turnover will be able to continue to do so.

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?

There were 115 responses to this question.

15. Views amongst respondents were mixed. Some respondents suggested that VAT should be kept completely separate from updates for income taxes, whereas others asserted that MTDfB needed to offer unified update functionality for both direct and indirect tax purposes.

16. Those who saw no issues with including VAT-related data with the updates asserted that it would be “easy” to include data about VAT schemes. Others were more cautious, agreeing the principle of unified updates where the software can submit this information without any additional work. Concerns were raised, however, on the capability of software to deal adequately with VAT special schemes; some suggested that products that do deal with VAT schemes currently often have limitations in terms of their accounting capability.

17. For those who were concerned about including VAT-related data in updates, common concerns were over the accounting rules and the different requirements of each tax.

18. Some respondents suggested that even for businesses with fairly straightforward affairs, adjustments often need to be made for VAT purposes which are not directly derived from the core data, such as including a private fuel scale charge, claiming input tax on the fuel element of a mileage allowance, bad/doubtful debt relief, private use disallowances, and correcting an earlier duplication or omission. A further issue raised was that income tax quarters will not necessarily be the same as the VAT quarters for the business, if the business chooses not to align them.

19. On timescales for implementing any additional dataset requirements, one respondent observed that it can take large companies two years or more to change their systems, so that with implementation due in April 2019 the final requirements would have to be available/publicised very soon or the timescale will be unrealistic.

Government response

20. The government recognises the concerns respondents have about submitting additional VAT data in the MTDfB updates. Businesses with complex schemes and VAT calculations were particularly against additional data. A wide range of businesses also expressed apprehension about the level of uncertainty and change they would have to manage in April 2019, when VAT comes within the scope of MTDfB.

21. The government has therefore decided that from April 2019 the MTDfB VAT updates will only include the existing dataset from the current (nine box) VAT return. However, it will also explore the possibility, with software providers, of developing the functionality for businesses to submit additional VAT data voluntarily. This will allow HMRC to test the extent to which customers could benefit from additional data – this could be through improved prompts and nudges or through reduced burdens from better targeted compliance interventions.

22. EC sales lists are a current information requirement from those VAT- registered businesses trading with other EU countries but the information is not required digitally. The government will make it mandatory, for those businesses that currently submit this information, to do so digitally. HMRC will work with the software providers to ensure the necessary products are available.

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

There were 101 responses to this question.

23. Where respondents agreed with the principle of regular updates, there was a desire to maximise flexibility around update cycles. In particular many respondents wanted flexibility to allow businesses to align VAT and income tax updates.

24. The main issue identified with flexibility was the fixed quarterly cycle. A number of respondents questioned the need for a maximum period of three months between reporting cycles and wanted longer periods between updates. A number of respondents called for complete flexibility with the option for only one update per year. Conversely, other respondents suggested that too much flexibility might prove counter-productive.

25. Particular issues were identified around flexibility for seasonal businesses. A suggestion was that seasonal and small businesses should be permitted a longer reporting cycle with six monthly periods, rather than three monthly or the flexibility to submit updates during quieter periods or that there should be an option to apply for a dispensation to file updates at more suitable intervals to fit with the trade. Similarly, flexibilities would be welcomed by those businesses with non-standard accounting periods, for example to the last Friday of each calendar month.

26. Further issues were raised around taxpayers who have multiple trades with different year-ends or who have both a trade and a rental business, with the quarter end potentially being chosen for business reasons, such as seasonality, rather than necessarily to coincide with reporting deadlines on other businesses.

Government response

27. The government wishes to provide sufficient flexibility for businesses to manage their multiple priorities within the context of requiring a regular flow of update information. Businesses already have the flexibility to choose their periods of account and will have the flexibility to change their update periods, as suits them best.

28. The three month period plus the one month submission deadline gives a four month time span, which the government believes should generally be sufficient to accommodate any particularly busy period in the annual business cycle.

29. The government also wishes to provide a degree of flexibility to complete an update before the quarter end (where, for example, a business is going on holiday or trading is complete for the quarter), so it will be possible to submit an update up to 10 days before the end of the quarter, for the whole quarter.

30. Flexibility to align MTDfB and VAT updates will be available but as respondents point out, taxpayers with complex business arrangements involving multiple trades with different year-ends will inevitably end up with multiple obligations.

31. Businesses already have flexibility to change their period of account or their VAT return cycle and this makes possible the alignment of their VAT and income tax periods so that businesses can submit simultaneous updates, where they wish to do so. The government also intends to allow businesses to change their income tax update cycle so they have the flexibility to choose on which day and which quarterly cycle their updates fall.

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?

There were 99 responses to this question.

32. Some respondents agreed that a month after the end of the quarter was adequate time for an update to be made. However, the majority of respondents suggested a one month time limit presented practical difficulties, particularly for businesses reliant on agents to process and submit the update. Some suggested that the proposal would lead to the quarterly submission of significantly incomplete and/or incorrect data.

33. Amongst those suggesting that a month was too short, alternatives were put forward ranging from an additional 7-14 days to two or even three months. However, some accepted that it would be better to start with a short period and

apply no penalties in the early years rather than to have longer periods that are subsequently reduced.

34. Of those who considered the one month deadline to be adequate, some indicated that due to the seasonal nature of some businesses, it was not unusual for extended holidays to be taken and thus deadlines missed. Conversely, it was suggested that any more than a month would render the output out of date and potentially of little value.

35. The question of alignment with VAT returns was a constant theme - a number of respondents acknowledged that there was sense in aligning the quarterly update and VAT submission filing deadlines, but identified that reducing the VAT filing deadline by seven days may prove an issue for clients that have internal month end procedures (including payroll) to deal with, and that a potentially better solution would be to align with the existing VAT return deadline rather than shortening this deadline.

36. Another concern was that if updates were to require bank information a month may not align with the timing of the issue of bank statements and so may cause problems unless a business also adopts online banking.

37. Concerns over the call on agent resources were a common theme among those agents responding, with the suggestion that they would end up with a ‘quarter end’ rush every quarter and thus it may not be feasible for them to turn around all their clients within one month. This could lead to resource pressure in some periods, and under-utilisation of resources in others. Even with staggered reporting periods amongst clients, this could potentially lead to additional costs in ensuring sufficient staffing for the latter half of each month.

Government response

38. The government understands the concerns that businesses and agents have about the need for time to submit the update and the desire not to create work peaks. However, the updates are intended to be quick submissions of receipts and expense data that reflect the trading recorded in a business's records. The month’s submission period is not intended to be a lengthy window of time in which a business starts to enter all its transactions in the digital records from paper. If a business has been keeping digital records ‘as they go’, the update should be straightforward to generate and send.

39. A one month deadline seeks to strike a balance between the regular updating of timely information while still allowing businesses a time interval after the end of their period in which to enter any final transactions, make any adjustments they may wish to make and find a convenient time to submit the update. This one month deadline would also apply to VAT updates.

40. A two to three month interval after the period end in which to submit updates would risk undermining the principal aim of MTDfB of ensuring that a business is keeping up to date digital records that are then reflected in the update.

41. The current VAT return deadline allows a month and seven days for filing (with a further three working days for those on direct debit). The additional 7+3 days would still be available, but only for payment (not updating) of VAT due.

42. Businesses will be free to change their quarterly cycle to end on any day in the month, which should help mitigate any 'quarter end' rush for agents.

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

There were 97 responses to this question.

43. Nearly all respondents agreed that the transition to MTDfB should be achieved in the most straightforward way possible.

44. Most respondents agreed with option 1, i.e. that a business should start its update obligations under MTDfB with effect from the first accounting period beginning after 5 April 2018, with the first quarterly update obligation arising three months after the start of this accounting period. Respondents flagged the risk of software issues and error if a business tried to combine a non-MTDfB period with a MTDfB period for its 2017-18 accounts. Continuing to allow modification of reporting periods for businesses with a year-end between 1 and 5 April was also agreed to be a sensible measure.

45. Concern was raised that under option 2 businesses would have part of their accounting period outside MTDfB and part within MTDfB when they first 'join' MTDfB. It was suggested that any submissions prior to that would be meaningless as the previous period figures would not be included and that it makes no logical sense for the business to provide partial year-end data. It was suggested that this would be also prove confusing for many businesses.

46. In response to option 3, some respondents also suggested that VAT registered businesses should be able to align MTDfB update periods with VAT quarters for simplicity, with the view that if the VAT quarters are not aligned to the accounting period this may mean additional MTDfB updates will be required in the first accounting period. Conversely, other respondents expressed the view that it would result in bringing VAT registered unincorporated businesses into MTDfB earlier than intended and thus represent an additional burden.

Government response

47. The government is keen to make the start date for businesses to meet their MTDfB obligations as straightforward as possible and therefore will proceed with option 1, the proposal that business obligations arise with effect from the first accounting period beginning after 5 April 2018.

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?

There were 82 responses to this question.

48. Respondents largely agreed that software should identify where a figure has been amended after an update has been made, and have the capability to identify these changes and include the effect of them in the next quarterly update. This was deemed necessary to ensure the four quarterly updates will accurately reflect the annual position.

49. Caution was advised, however, that error correction can be a tricky area even for experienced users of accounting software, with the most common issue being how to deal with a late or omitted invoice after a period end routine has been run. Respondents urged, therefore, that any amendment process should be as straightforward as possible.

50. It was suggested that, because each update in an accounting period adds to the previous updates to give a cumulative position for the business for the accounting period, a sensible approach would be for amendments to MTDfB updates to be dealt with in a similar way to corrections to VAT returns, with any amendment made in the next update so that the cumulative position is corrected once the later update is filed.

51. This approach was echoed by many with the view that any errors encountered post-update should simply be recorded in the current period without need to amend the previous period as this would significantly increase the time spend with no obvious demonstrable benefit. It was suggested that amendments to previously reported periods were difficult to achieve and thus there should be no reason to amend the previous period at all unless after year end.

Government response

52. The government agrees with the view that amendments need to be as simple and straightforward as possible. On identifying transaction recording errors or omissions, business will enter them in their record-keeping software.

53. When the business submits its next update, the software will automatically recognise any changes to previous updates. It will allocate the amendments to the correct update periods and seamlessly submit the revised information to HMRC alongside the current update.

Chapter 6. 'End of year' Activity

1. Chapter 6 explored 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 this.

2. Having provided HMRC with regular updates throughout the year, building a picture of their tax position, businesses would not need to spend as much time and effort at the end of the year gathering details of expenditure and income from business events up to a year earlier.

3. The chapter set out that for the million or so businesses using the cash basis of accounting for income tax, 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.

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

There were 89 responses to this question.

4. Overwhelmingly, the responses indicated that finalising the regular updates should be a separate process to the process of providing HMRC with updates. This was primarily to provide businesses the time to consider accounting adjustments and seek the advice of their accountant.

5. Some respondents agreed that those businesses that use the cash basis for income tax may be able to finalise their position at the same time as providing their final update. This approach was caveated with the need for clarity on when a business must decide on what basis it will be calculating its profits.

6. Those respondents who did not agree that the process of finalising the regular updates should be separate to the regular updates felt that it effectively meant an additional update was required. This would mean an additional burden on the taxpayer.

7. Respondents asked whether software would be able to conclude automatically the year's submission after providing the updates, with the option to review prior to submission.

Government response

8. The government notes the broad support for the process of finalising the regular updates at the end of a period of account should be separate to the regular updates. As outlined in the consultation document, it will be possible for businesses to provide their end of year activity at the same time as their final update. This will provide the seamless experience that some businesses desire

whilst ensuring businesses that wish to seek professional advice continue to have the opportunity to do so.

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

There were 81 responses to this question.

9. The majority of the respondents disagreed with the proposal that businesses should have nine months to complete any end of year activity, highlighting potential issues for businesses, accountants, agents and HMRC.

10. The concerns raised focused primarily on the creation of a new peak at 31 December for any businesses with a 31 March or 5 April year-end. Respondents felt that as the current Self Assessment deadline of 31 January was well established it would be more sensible to have a ten-month period for completion of the end of year activity.

11. Some respondents considered that for more straightforward businesses, such as those which use the cash basis for income tax, a shorter period to finalise their end of year activity would be appropriate.

Government response

12. The government recognises the strength of concerns that respondents have raised, particularly focusing on the impact on agents and businesses over the Christmas period.

13. The government is keen to provide businesses with a closer to real time understanding of their tax affairs. Respondents rightly pointed out that many businesses already have a ten month deadline and that little was gained at this stage from shortening this to nine months. We note that it is also possible for businesses to have a period of account that results in them providing a return on 31 January relating to income earned twenty-one months prior.

14. Therefore, the government has revisited the proposed design of the end of year activity and can confirm that the deadline for providing the associated data will no longer be nine months. Instead the government will introduce legislation which will require that the end of year activity has to be provided by the sooner of 10 months after the last day of the period of account or 31 January of the year of assessment in which the profits for that period of account are chargeable to income tax (the existing Self Assessment deadline).

Chapter 7. Exemptions

1. This chapter examined those businesses exempted from obligations under MTDfB.

2. The consultation document confirmed that all unincorporated businesses and landlords with turnover or gross annual income from property of below £10,000 would be exempt from the new obligations. It proposed to defer implementation for a limited group of businesses and landlords with gross annual incomes above that threshold.

3. By 2020, 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. All exempt businesses will be able to update HMRC using software or apps, but on a voluntary basis.

4. The consultation sought views on the appropriate threshold for exemption and on how eligibility for deferral should be defined.

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

There were 82 responses to this question.

5. Many of the responses to this question concentrated on the size of the business, mainly in terms of income or turnover, and on the ability to engage digitally. Some others referred to specific groups. The latter are considered further on in this document.

6. It was commented that in fairness to all taxpayers, a business should only be exempted from the requirements if there was a circumstance particular to that business (or business type) that made compliance impossible. But other respondents suggested that exemptions should not be based on business type as it would be difficult to define these accurately.

7. It was proposed by some respondents that no VAT-registered business should be exempted from the requirements of MTDfB, on the basis that they were already engaging with HMRC quarterly and therefore least likely to feel an additional burden.

8. Common suggestions for businesses that should be exempt included:
    - those businesses which were unable to access suitable accounting software
    - those businesses that are currently exempt from filing tax returns
    - lack of decent broadband and mobile coverage, as MTDfB requirements would put them at a disadvantage over those businesses who had access to reliable and fast broadband and mobile coverage

- not for profit organisations, where the time and cost outweighs the benefit for the business and HMRC
- non-tax paying entities
- level of complexity of the business
- those businesses with a significant seasonal element, where quarterly figures are likely to give a very misleading impression of the final tax liability (farmers were cited)
- those with extremely variable income that may need to keep registering and de-registering for MTDfB

Government response

9. The government agrees that special measures will be required for those taxpayers that are genuinely 'digitally excluded'[5] and will legislate to ensure this is achieved. The government notes the other responses to this question and has considered these below where they overlap with the other questions raised on specific exemptions.

10. The government does not think there is one single set of criteria that can be used to determine whether a business should be exempted from the MTDfB requirements. It has therefore considered exemptions on a case-by-case basis.

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

There were 91 responses to this question.

11. A considerable majority of respondents were of the view that charities should be exempt. The main reason for this was the charitable sector's reliance on volunteers. It was thought that the regulatory requirements of MTD could discourage volunteers, having a severe impact on charities' survival.

12. Another factor was costs, with several observing that charities would incur a transition cost, and they did not want the charitable sector to be negatively impacted.

13. However, some respondents saw a benefit for charities from taking part in MTDfB around the potential to integrate their Gift Aid claims. There were also advantages perceived for charities in maintaining digital records. Charities would have the opportunity to opt into MTDfB voluntarily, which it was expected many would do. It was also suggested it would be helpful if HMRC produced some charity-specific guidance on MTDfB.

14. The current position of charities - with most not required to file an income tax or corporation tax return - was seen as an important consideration, and that if the main purpose of MTDfB was to give customers certainty that they are paying the right amount of tax, there seemed little point in forcing a charity to comply

[5] See government response to question 34 for definition of 'digitally excluded'

with MTDfB when in practice it was highly unlikely to ever have any taxable income.

15. It was acknowledged that some charities have taxable income to report. A few respondents suggested only small charities should be exempted, and that large charities should be capable of coping with the requirements better than small non-charitable businesses. Some suggested that only those that were VAT registered should be brought in initially.

16. A few respondents opposed an exemption for charities. The main reasons given for this were the fact that some charities had taxable activity and therefore should follow the same processes as other businesses; and concerns that the software industry would not offer record-keeping products suitable for charities unless mandation created a demand for them.

17. One respondent commented that charities' VAT positions were often more complex than other businesses, due to various partial exemption calculations, and they were also concerned about the availability of, and cost of, software to handle these. Another referred to charities that were not registered with the Charity Commission, but were still given charitable status for tax purposes by HMRC; notably "charitable community benefit societies" - and stated that these should be granted any exemptions that were given to registered charities themselves.

Government response

18. The consultation document made it clear that HMRC considered it appropriate for charities to be exempted from the MTDfB requirements, whilst commenting that there were 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. Having considered all the responses our view remains unchanged, and the government will therefore introduce legislation to exempt charities from the MTDfB requirements.

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

There were 142 responses to this question.

19. Responses to this question were polarised between those who felt strongly that trading subsidiaries of charities should not be exempt, and those who felt the charitable link gave particular grounds for an exemption.

20. The primary reasons for not having an exemption were:
    - All trading businesses that aim to make a profit should be within MTDfB (subject to any overarching turnover threshold)
    - An exemption would be an additional unfair commercial advantage

- If businesses derive benefits from digital systems then charitable trading subsidiaries should be encouraged to benefit from those changes also
- Charities that have the knowledge and resources to set up trading subsidiaries should be able to cope with MTDfB
- They are currently required to submit corporation tax returns and possibly VAT returns

21. Those who believed that trading subsidiaries should be exempted largely focussed on the connection to the charity, and that if the charity was to be exempted, there were good reasons for also exempting the trading subsidiary. Arguments additional to those covered under question 31 were:
    - different accounting requirements should not be imposed for the trading subsidiary as for the parent
    - they usually only pay tax on bank interest received as most profit will be gift aided to the main charity, to be used for charitable purposes
    - the vast majority will have been set up with the intention and expectation of having nil, or virtually nil, taxable profit
    - there was no competition with other non-charity affiliated businesses in the real sense - the requirement to set up the subsidiary was often dictated by administrative, legal and financial practicalities, with common resourcing across the charity and subsidiary

22. As with charities themselves there were references to the size of the trading subsidiary and a suggestion that the larger ones (e.g. those with turnover above the VAT threshold) were very much run as commercial organisations.

23. As all charitable trading subsidiaries are incorporated entities, it was suggested they were outside the scope of this consultation and should be covered later when HMRC consults on the application of MTDfB to the corporate population.

24. A recurring theme was the donation of profits from the trading subsidiary to the parent charity, resulting in no tax liability on the trading subsidiary due to specific legislation allowing the donation to be treated as a taxable deduction. It was suggested that only those charitable trading subsidiaries that did not gift all their profits to the parent charity should be within MTDfB.

Government response

25. Charities often establish trading subsidiaries to keep the trading activities separate from the charitable activities, and because profits are starting to exceed the small, trading profits exemption limit available to charities. This puts their business activities on a closer footing with non-charitable businesses.

26. While the proposal to exempt those trading companies who distribute all profits to charity (and therefore had no corporation tax liability) had some merit, they could still have substantive VAT obligations. A significant reason for exempting charities is that many of them do not currently have to submit a tax return, and have a number of reliefs available to them for VAT purposes. Additionally, we considered there would be non-charitable businesses who ordinarily would submit a return but sometimes have no liability to direct tax, but will still be

within the scope of MTDfB. This weakens the argument for exemption for trading subsidiaries owned by charities for having no taxable profit and therefore no direct tax liability.

27. Accordingly, the government's view is that trading companies owned by charities should be within the scope of the MTDfB obligations.

Question 32: Should Community Amateur Sports Clubs (CASCs) be exempt from the requirement to maintain digital records and to update HMRC at least quarterly?

There were 98 responses to this question.

28. The responses to this question closely mirrored those to question 30 on charities. There were very few new observations wholly related to CASCs, although it was noted that there were likely to be fewer large CASCs than large charities, and CASCs were likely to have even less sophisticated systems than most charities. It was observed that HMRC was usually consistent in its approach to charities and CASCs, so their treatment under MTDfB should likewise be aligned.

29. One observation noted that CASCs fell within the corporation tax regime and therefore a decision on their treatment should be for a later consultation.

Government response

30. The government believes the treatment of CASCs under MTDfB should align with the position for charities, and will therefore exempt CASCs from the MTDfB requirements. CASCs will still be able to participate voluntarily.

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?

There were 60 responses to this question.

31. Many respondents considered MTDfB requirements during the insolvency process would increase the insolvency practitioner fees and decrease the amount available for distribution to creditors. As there was usually insufficient money for creditors, MTDfB could therefore exacerbate this.

32. It was thought there would be no benefit from submitting quarterly updates as these would have very little relevance for tax purposes. Most transactions would simply be realising assets and paying off creditors. Although some might still have an ongoing business managed by an administrator, the wide variety of possible circumstances meant mandatory adoption of MTDfB would be inappropriate.

33. Another factor involved the state of the records when a business entered the insolvency process.

34. Some respondents thought that these businesses should not be exempt. Many did not see any particular problems for this group of businesses that would require any special treatment.

35. Several respondents considered that, if they were not exempted, special arrangements would be required for this group, although limited suggestions were offered, on what form this might take. One respondent suggested including flexibility for quarterly information to be submitted digitally in a non-standardised format.

36. There was support for some form of online arrangements for insolvent businesses, rather than the current paper-based filing. The importance of involving the insolvency industry in discussions on the arrangements for this population was stressed, and a suggestion made that a separate consultation should take place with those specifically involved in this area, to ensure their opinions were fully taken into account in the decision-making.

Government response

37. Insolvent businesses and those Insolvency Practitioners (IPs) managing their affairs are currently exempted from corporation tax and VAT online filing requirements. Practical difficulties in accessing the digital records and tax account of an insolvent business could make MTDfB especially challenging.

38. We recognise the concerns about access to and security of digital records, access to accounting staff, and the potential for associated fees to reduce the amount available for distribution to creditors. As the term, "insolvency" covers a multitude of scenarios we believe more work is required to discern which types would be able to engage with MTDfB, and those that cannot.

39. We have already begun discussions with IPs and their representatives and will continue these over the next few months. In the meantime, the government will bring forward legislation to exempt businesses within the insolvency process from the scope of the requirement to maintain digital records and to update HMRC quarterly at this stage, with the expectation that they will be brought into the scope of these obligations at a later date.

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

There were 71 responses to this question.

40. Many respondents agreed that alignment with the current exemption from VAT online filing was appropriate, ensuring that businesses exempt under the VAT legislation would also be exempt from MTDfB. A number of respondents identified the issue of broadband coverage, suggesting that those without high-

speed broadband should be exempt from MTDfB given the difficulties it will otherwise impose on them. Others did not necessarily see this as an issue, believing that this should not be a reason for exclusion given that the data uploads anticipated were small, and that many would be engaging agents to make updates.

41. Considering the definition of exclusion, some cautioned that it is important to distinguish between those who cannot engage and those who would not know how to.

42. Some stakeholders suggested that age should be the basis for exemption. The VAT exemptions currently consider whether online filing is impracticable by reason of age. Some respondents took this a step further with the suggestion that there should be a blanket exemption for business owners over the state pension age.

43. Others, however, took the view that age should not be a barrier, suggesting that a more appropriate approach would be to offer the opportunity to engage digitally to those who feel comfortable in doing so, without mandating those who are not.

44. Finally, caution was urged that when considering an exemption, HMRC must be pragmatic in their approach and not take the view that someone must have multiple barriers to engagement rather than just a single one. The point was made that any one factor may be sufficient for the exemption to apply and there should be no suggestion otherwise, whether in guidance or customer communication.

Government response

45. The government agrees that access to broadband, age, remoteness of location and disability must all be taken into account when determining whether someone can engage digitally. The government agrees that it is possible for just one of these factors to be sufficient to ensure that a person does not find it reasonably practicable to comply with the MTDfB obligations; and will make this clear in any guidance and relevant communications.

46. The government will legislate for an exemption to MTDfB for taxpayers who cannot engage digitally. This exemption will be based on the existing VAT online filing exemption and will therefore exempt the following groups from the MTDfB requirements, where HMRC is satisfied that they qualify:
    - a person who is a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications; and
    - persons for whom MTDfB is not reasonably practicable for reasons of disability, age, remoteness of location, or any other reason.

47. The government will ensure that taxpayers are able to apply easily for an exemption to MTDfB and that non-digital means of applying for this exemption are available. The government will also ensure that taxpayers are clearly informed of the choices available to them.

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?

There were 92 responses to this question.

48. Most respondents viewed the £10,000 exemption threshold as too low, suggesting that the imposition of the MTDfB obligations on businesses on such a low income would be unreasonable.

49. A number of respondents suggested that the exemption should be linked to the income tax personal allowance, questioning what benefit those with turnover between £10,000 and the Personal Allowance would see from MTDfB.

50. Others raised the point that businesses with turnover between £10,000 and £20,000 would be unlikely to be paying tax and thus there would seem little value in them filing quarterly updates when ultimately there were no tax implications arising. It was suggested that particularly for those businesses with an agent that had little to no tax to pay, the additional costs arising through quarterly engagement with the agent could negate the benefits.

51. Some respondents suggested the ‘annual income’ for exemption should be based on profit rather than turnover, as profit is a better indicator of affordability than turnover. However, most respondents agreed that turnover was the only workable basis for the exemption.

52. Although some respondents suggested exemptions for businesses with turnovers up to £500,000, with progressive reductions over a period of time, the majority of respondents suggested that the exemption should be linked to the VAT threshold. The assertion was made that VAT registered businesses that already have to submit electronic VAT returns quarterly would be better prepared to move to MTDfB submissions, and that mandation for smaller businesses should only follow if benefits were seen by both business and HMRC.

Government response

See below - the government has provided a combined response to questions 35 and 36.

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?

There were 113 responses to this question.

53. Most respondents called for a high-income threshold and a longer deferral period. Many based this view on the perception that the timescales for introducing MTDfB are too tight.

54. Some commented that larger businesses should be the first to adopt MTDfB, with other businesses coming into the process at a later date, which would allow the system to bed in gradually. Other respondents, particularly agents, called for at least an additional year to be given to all businesses to allow for both agents and business to prepare, with the assertion that there was little awareness of MTDfB amongst businesses and little certainty around how the new processes and software will work.

55. Some respondents suggested that VAT registered businesses should be the first to move to MTDfB, with mandation for smaller businesses only following if/when benefits were seen by both business and HMRC.

Government response

This is a combined response to questions 35 and 36.

56. Given the range of views expressed on this matter, the government will take more time to consider these issues, alongside the fiscal impacts. Final decisions will be made before legislation is laid later this year.

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?

There were 115 responses to this question.

57. The majority of respondents agreed that the proposed principles for determining eligibility for an exemption were correct and reasonable, with the proviso that there had to be proper guidance on their application.

58. Among those that did not agree with the eligibility guidelines, many suggested that they were impractical to operate where a business or individual’s income was widely variable from year to year, or unpredictable.

59. Others took the view that the VAT criteria should be mirrored, with exemption based upon either actual or anticipated turnover.

60. Some respondents urged caution with the application of the criteria, suggesting that previous behaviour will not always give an accurate guide to future behaviour. Although it was welcomed that a business should never be disadvantaged for unexpectedly receiving gross income which takes it above the exemption threshold, questions were raised as to how “unexpectedly” would be defined, particularly in relation to new businesses.

61. It was suggested that there was a need to allow for situations where it is known that financial results or turnover will definitely be below the exemption

threshold. Examples were given of the business having ceased or a period of hospitalisation.

62. Other additional criteria were not necessarily confined to financial issues, and explored changes in an individual's circumstances. Particularly cited were instances where someone has a fluctuating condition, with the observation that in such instances past behaviour will not be indicative of future compliance. Similarly, other life events were suggested as suitable for exemption from MTDfB obligations.

63. Further criteria suggestions were tied in with the broader exemption proposals, and where a business changes in status to become a charity or CASC during the accounting period. In these instances, it was suggested that the business or organisation should be exempted from MTDfB requirements from the point it changes status.

Government response

64. The government has published draft legislation setting out details of how businesses will be able to utilise exemptions from MTDfB.

65. The government believes that in order to make the exemption system work in a customer-friendly way, there will need to be two types of exemptions. The first type will be one that applies automatically to defined business types or activities (for example, charities). The second type of exemption will require businesses to identify whether they meet specific criteria and provide an opt-out where those criteria are met. This process will apply to the income-based deferral and exemption (government response to questions 35 and 36 above). It will also apply to the exemption for those who cannot engage digitally.

66. In order to provide certainty for businesses, the government will ensure that it is always clear whether a business is subject to the MTDfB obligations. Businesses will be either in or out of MTDfB for the duration of a tax year and all periods of account mapped onto that tax year. That means that businesses whose income fluctuates will always be clear which mechanism they will need to use to report their chargeable income. It will remain open to all businesses to participate in MTDfB on a voluntary basis.

67. To opt out of MTDfB based on the income, businesses will be required to demonstrate that their turnover for the previous tax year was below the threshold. They will also be required to confirm their reasonable expectation that their income for the following tax year (or periods of account that map on to that tax year) will also be below that threshold. Special rules would be needed for new businesses.

68. Where a business has opted out based on an incorrect view that their future income will be below the income threshold, they will move back into MTDfB for the following tax year.

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

There were 71 responses to this question.

69. The responses to this question ranged widely and covered many niche areas, often affecting a relatively small number of businesses. A common response was that those whose activity was not subject to tax by virtue of specific legislation should be exempted from MTDfB. Examples of this were the occupation of woodlands on a commercial basis, Local Authorities and National Park Authorities.

70. Lloyd's Underwriters were mentioned as a group where profits are declared and distributed to members much later than the end of the relevant business period, so that there is a mismatch between what is reported on, what is accounted for, and the tax that is chargeable.

71. Several respondents referred to trusts or collective investment schemes, where there are many different arrangements and possible tax treatments.

72. Mutual trading businesses were mentioned several times, as were friendly societies, investment clubs and agricultural societies, on the basis that in general they are exempted from almost all tax. Community interest companies - social enterprises designed specifically for those who wish to operate for the benefit of a community rather than the company owners – were also mentioned as, although taxable on trading profits, frequently they do not carry on a trade.

73. Co-operatives, such as small consortium co-operatives formed by individuals who work and trade collectively, were suggested as a group - where the degree of distributed ownership, control and benefit could be used as a criteria for exemption.

74. It was proposed that members' clubs, many of which currently do not have to file a return and have no taxable profits, should be exempted. For these clubs, surpluses on income from transactions with full members are not liable to direct tax, normally because they do not arise from the carrying on of a trade, but receipts from "outsiders" (for example, visitors) are subject to tax as normal, as are other income and gains of the club.

75. It was suggested that the wide variety of organisational structures and associated tax rules for the sports and recreational sector made the application of MTDfB difficult. Particular criteria could be established to exempt some of these for example, those run on a non-profit distributing basis, or those run entirely by volunteers.

76. Additional specific groups mentioned were management companies run by tenants of residential properties, pension schemes, limited liability partnerships (LLPs) and dormant companies.

Government response

77. As per the response to question 29 above, the government notes that we do not believe there is one set of criteria that can be used to determine whether a business should be exempted from the MTDfB requirements.

78. In considering the response on further possible groups for exemption, we have taken into account particular complexities and current tax exemptions. We have also looked at both direct and indirect tax obligations, as we do not believe it would be helpful to a business to be within the scope of MTDfB for one of their taxes, but exempted from the scope of MTDfB for another of their taxes; the core principle is that a business will be within MTDfB for all of its taxes (that fall within the scope of MTDfB), or exempt from MTDfB for all of its taxes.

79. The government has decided to bring forward legislation to exempt Lloyd's Underwriters in recognition of the significant mismatch between what would be reported in an update for a period, and when what is reported would fall to be taxed.

80. The government also recognises the complexities of trusts, which cover a wide spectrum of activity from unit trusts to settlements trusts, and as necessary HMRC will be considering some of these further in our design work on complex and incorporated businesses. However, the government has decided it will bring forward legislation now to exempt the following:
    - Exempt Unauthorised Unit Trusts (EUUTs)
    - Property Income Distributions to individual shareholders in Real Estate Investment Trusts (REITs) and Property Authorised Investment Funds (PAIFs)

81. The trustees of Exempt Unauthorised Unit Trusts come within the charge to income tax, but the specific tax rules applying rarely result in any tax liability, and they fall outside the scope of VAT. Property income distributions are treated in legislation as profits arising from a property business; however, for MTDfB purposes we recognise that the income is more akin to investment income, than income from the running of a business.

82. Where a business is specifically exempted from income tax or corporation tax we consider it falls outside the scope of MTDfB for that tax. However, if there is no similar exemption from VAT then it falls within the scope of MTDfB for VAT. The principle of a business being within MTDfB for all or none of its taxes holds good, as the only tax within the scope of MTDfB for which it is liable is VAT.

83. Although the government has already decided to exempt some entities which come within the charge to corporation tax, the consultation document primarily focused on unincorporated businesses, and HMRC indicated a further discussion document on incorporated and complex businesses (to include those unincorporated associations falling within the charge to corporation tax) would be published at a later date. HMRC will consider the MTDfB status of members' clubs established for their own social or recreational objectives, friendly societies, community interest companies and mutual trading status businesses, as we take the work on incorporated businesses forward in 2017.

Chapter 8: Updated Assessments of Impacts

1. This chapter sets out HMRC's initial assessment of the impacts of the new MTDfB requirements for businesses to maintain digital records and provide quarterly updates. HMRC recognised that it needed to understand better the impacts of the new MTDfB requirements across the business population, and it said that it would work extensively with stakeholders to develop further the evidence base.

2. The assessment in the consultation represented HMRC's initial view of the impacts on businesses, and was based on its early assumptions around obligations for business using available data for small unincorporated and incorporated businesses with fewer than 20 employees.

3. The initial assessment set out two broad scenarios for how businesses may be impacted, but with the caveat that any final estimates of the impacts could be quite different from the scenarios represented. HMRC emphasised that it wanted to review and test its analysis and assumptions through extensive engagement and consultation with businesses and other stakeholders, and through further research and analysis.

4. In the scenarios presented, HMRC assumed that 42 tax obligations were in scope for the changes proposed under MTDfB. These obligations included providing HMRC with the information required for a Self Assessment 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.

5. As detailed in the consultation, HMRC mainly uses 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 and so provides a consistently calculated and informed set of estimated costs for each tax obligation, averaged across the entire business population.

6. HMRC was clear that the SCM estimates represented its initial assessment of impacts on business, and that the broad estimates presented would be subject to further review as HMRC continued to test its analysis and assumptions through the consultation process and extensive engagement with businesses and other stakeholders. HMRC has used the feedback received to review its modelling and further develop its estimates, bringing into the model the full range of tax obligations covering the majority of the unincorporated business population. Annex B to this document details the methodology of the updated model used. Annex C provides an updated 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.

There were 159 responses to this question.

7. Responses, from agents and representative bodies, expressed scepticism at the level of savings or reduction in time spent completing returns, as their clients and members would still be likely to request them to review the updates before submission to HMRC. Some held the view that prompts and nudges could be confusing, as they will need to update the software every time tax legislation is altered or a new court decision is issued.

8. A number of respondents expected to incur additional costs from requiring additional support from agents, but were unable to give details of the figures involved. It was suggested that any savings realised would be largely reliant upon availability of good, free software incorporating functionality that makes it easy to record transactions, with the concern that if this is not done, or manual categorisation is required, customers might not pay sufficient attention to the data input, with the suggestion that you can't have both "quick" and "accurate".

Government response

9. The government recognises both the strength and range of views.

10. Businesses have always had the responsibility to keep accurate records to calculate their tax liability. Where receipts and invoices are scanned or otherwise captured via a smartphone app, or in software, software capability will enable rapid processing and categorisation of records in a format ready for submission for quarterly update or end of year activity. HMRC believes that this will save time overall, once the business has had time to adjust to the new regime, whether it is the business recording the transactions or, where agent services are used, the agent's time and consequently cost.

11. The introduction of basic prompts and nudges is intended to help support businesses get their tax affairs right, provide targeted guidance and reduce the need to review and rework submissions to make amendments and the risk of unwelcome and costly HMRC compliance interventions. HMRC continues to work with the software industry to ensure that they provide secure and accessible products that are helpful to businesses and have been extensively user tested to make these messages as helpful as possible to users.

12. HMRC recognises that MTDfB represents a change to the way in which many businesses manage their record keeping. HMRC recognises the concerns and is committed to helping businesses make the transition to MTDfB as smooth as possible.

13. Once MTDfB is bedded in, HMRC believes that that it will be easier for businesses to get their tax right, with less error and costly rework. The experience will also start to resemble more closely what businesses are used to

from their dealings with other service providers: secure, personalised and user-friendly digital services through which the business can do all that they need for their tax.

14. HMRC will continue to engage with both businesses and other stakeholders throughout 2017 to improve our processes where necessary and support businesses to realise the benefits of MTDfB.

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

There were 84 responses to this question.

15. A number of respondents immediately recognised that MTDfB would bring transparency, structure and efficiencies to many businesses' tax affairs.

16. Businesses whose accounts are prepared using the cash basis were seen as likely to benefit due to better record keeping and the ability to record transactions "on the move". Residential landlords would be likely to see benefits, for similar reasons. It was suggested that capturing expenditure by using an app would result in fewer receipts being lost, which could lead to smaller tax bills.

17. Some respondents suggested that those businesses that already operated in a digital environment and understood the benefits of digital accounting would see benefits, as well as those smaller businesses that are big enough to benefit from using digital management information but have not yet made the step from manual, or partly manual, accounting and control systems.

18. Others identified that for larger businesses that already operated digital accounts the step would be a relatively small one. Particularly cited were VAT registered businesses that would already be performing quarterly activity; these were also seen as unlikely to have issues with implementation.

19. Others took the view that the larger the business, the bigger the potential benefits. Another potential benefit identified was that better record keeping would likely lead to fewer HMRC enquiries, and thus in itself produce savings.

20. Many respondents were keen to see more detail before determining benefits for different sectors.

Government response

21. The government notes the range of views expressed. As respondents have identified, MTDfB has the potential to deliver real benefits across the business spectrum.

22. Around two million small businesses already use software to either keep their records, or produce their accounts or tax computations, so the transition to operating MTDfB will be a relatively easier step for them.

23. HMRC envisages the biggest change, and potentially the greatest benefit, is for those businesses that are currently keeping their records on paper, irrespective of their size. The transitional challenge is also bigger for these businesses. These benefits could be realised in terms of efficiencies, time savings and cost. By keeping digital records of trading and transactions, they will better understand their tax position in-year, whether by using the MTDfB software or through their digital tax account, be better able to plan expenditure and investment and will be able to update HMRC simply and accurately at the press of a button rather than the current requirement to complete a lengthy tax return.

24. The government recognises, however, that MTDfB represents a significant change for some businesses, and that for these businesses the benefits may not materialise immediately. HMRC is committed to delivering these changes in a way that works for all businesses, and so will continue to work with businesses and other stakeholders to ensure these changes are a success for HMRC and business alike.

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 that are not covered above.

There were 170 responses to this question.

25. All the responses expect there will be additional costs from ongoing software subscriptions and some time lost in adapting to the new MTDfB obligations.

26. The time spent on familiarisation drew mixed views. Many respondents felt there was insufficient information provided to be able to draw firm conclusions, but instead based their responses on experience of installing other systems and processes. Many, however, observed that the time spent on familiarisation would depend on a number of variables, from the complexity of the business to the digital capability of whoever will be dealing with the accounts, so was impossible to quantify.

27. Most envisaged non-productive costs to the businesses moving to MTDfB, from the time spent in selecting software, learning how to use it, adapting processes to fit software needs. It was suggested that this time and cost would vary from business to business depending on the complexity of the business and consequently its software requirements.

28. A number of agents suggested that a significant proportion of their clients lacked any form of computer literacy, and thus would find adapting to MTDfB difficult.

29. A number of respondents suggested that for agents and bookkeepers' familiarisation time could be significant as they will both be advising clients and learning processes themselves.

30. Turning to the cost of the software, most respondents were unable to quantify the costs, but observed that many businesses were likely to incur some software costs in either purchasing or upgrading their software.

31. A number of respondents agreed that annual software costs could be in the region of £250-£350 a year for a subscription to a cloud-based service; some respondents suggested significantly lower costs (particularly for those with simpler affairs), equally others suggested costs would be higher.

32. The third part of the question related to hardware costs. As with software costs, the responses were many and varied, with some respondents suggesting that they would need no additional hardware at all, and others believing that as a minimum they would need to upgrade a smartphone and a computer. As with software, few were able to quantify specifically the costs. Many agents responded with the assertion that a "surprising" number of their clients did not have computers or any inclination to do so.

33. Amongst those who already had computers and other devices, concerns were expressed that they would need updating. Some respondents suggested costs were in the region of £300 to £450 for a basic system, although a few estimates were as high as £2,000. Additional hardware needs anticipated extended to scanners to scan receipts / invoices and external hard drives to store records digitally.

34. Answering the question concerning any other costs, training and familiarisation costs were again highlighted, along with agent assistance and staff time in making the updates. Some suggested that in the initial years it was likely businesses would run their existing systems in parallel with new systems and thus the early years burden would include maintaining two sets of records, i.e. the existing system and the new system required under MTDfB.

Government response

35. Ofcom's 2016 statistics indicate that 59% of homes now own a tablet device and 71% of UK adults now have a smartphone. 97% of small and medium-sized businesses have access to online services. The government sees this as a clear indication of the public's appetite for digital services and a degree of digital capability across the small business spectrum.

36. The government understands that costs are a crucial factor for business, and that both transitional and steady state costs in moving to the new MTDfB

requirements are key areas where HMRC needs to further develop its understanding and identify needs. HMRC will be working directly with a range of small businesses to identify the specific costs they incur both during transition and at steady state. We also understand customers' desire to "get things right" with their tax affairs. HMRC will continue to work with developers around the MTDfB software and help customers to reduce error.

37. HMRC recognises that it is essential businesses get the help and support they need to make MTDfB successful for them and will be targeting that help at those businesses that have the most need of it, whether by phone, webchat or online assistance / guidance.

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.

There were 163 responses to this question.

38. Nearly all the responses assumed there would be additional costs, particularly due to increases in accountancy fees. Time costs were an additional factor.

39. Some believed they would need to rely on an agent at every step of the MTDfB process, however others suggested that the opposite may be the case.

40. Of respondents who currently engaged agents, many anticipated continuing to do so under MTDfB, for both the final update submission and the quarterly updates. Some businesses assumed the cost of engaging their agent / accountant would multiply by 5 on this basis.

41. Agents largely anticipated that their clients would require additional support on an ongoing basis to oversee the operation of their bookkeeping system and assist with the quarterly submission to HMRC. It was thought that there would potentially be a saving in the cost of compiling year-end accounts but businesses would still see a net increase in costs.

42. Although many did not see that there was a sufficient level of detail provided to make an assumption of likely fees, some agents were specific in the additional charges that they would make to their clients. Estimates differed according to size of business and the agent's own fee structure. Estimates ranged from a doubling of costs at one end to a VAT registered company keeping manual records seeing a charge of around £100 per quarter to make the updates. A few estimates suggested that the average net additional cost would be around £125 + VAT per month.

Government response

43. The government acknowledges the work respondents have done to identify costs and that many were unable to make specific estimates of these costs. Those who provided numbers were a very small proportion of the overall respondents and none provided any detailed underlying analysis.

44. Many businesses may incur costs in moving to MTDfB. These costs may be lower for businesses already using digital tools, and higher for those currently keeping paper records.

45. HMRC remains keen to understand the impacts across all businesses, and improve its understanding of the population groups affected, the time businesses might take and the costs they may incur in complying with the new requirements.

46. HMRC understands that with a diverse customer base, any on-going costs are likely to vary, and that different businesses will have different needs. HMRC does not want to disturb the professional relationship that exists between customers and their agents, but is clear that for some (for example those currently keeping paper records only) that that relationship may change.

47. As part of its ongoing engagement with businesses and representative bodies, HMRC will continue to develop as thorough an understanding of these business impacts as possible to ensure that MTDfB is a success for both HMRC and its customers.

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.

There were 68 responses to this question.

48. Many responses cited difficulties around the capabilities of businesses to adapt to the new digital requirements through a lack of the requisite skill sets, with agents stating they will need to employ further staff to cope with the workload.

49. Amongst those businesses singled out by respondents as likely to have difficulties were those who worked largely outdoors or on the road or any business run by someone with lower levels of literacy and / or digital capability. It was suggested on this basis that the smallest of businesses would suffer the greatest impacts as obligations were being introduced that they had never had to have regard to previously.

50. From a practical perspective actors working away from home on tour for weeks or months with irregular or no internet access were deemed potentially to have difficulties. These difficulties included increased costs of accountancy, increased internet charges for expensive data usage, receipts in foreign currency and increased paperwork.

51. Specific issues were raised regarding difficulties for partnerships around responsibilities and burdens, which are addressed further at question 17.

52. It was also suggested that property income businesses would find the obligations difficult to comply with as property income is usually dealt with passively. Further suggestions included those with more than one business activity where the record keeping needs to be separate but the information needs combining for MTDfB, or those with low levels of income but for which complex returns were required such as some in the farming community, or those operating multiple trades (for example, service/retail) under one business header.

53. More generally, it was asserted that that those operating specialised trades such as farming will experience more difficulty, with a perceived lack of clarity as to whether many of the more specialised rules for accounting or taxation will be incorporated into MTDfB or the accounting and taxation software likely to be produced in time for its launch. For such businesses, the need for professional support was seen to increase potentially rather than decrease under MTDfB.

Government response

See below - the government has provided a combined response to questions 43 and 44.

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?

There were 98 responses to this question.

54. Many responses from agents foretold greater demands on them from their clients, leading to increasing workloads that will either require the release of some clients or increases in fees to bring in new staff. They raised concern about the proposed year ends (31 December) and likely additional costs. It was suggested that many sole practitioners will amalgamate or retire and it was likely that small businesses and landlords will find it more difficult to find an agent to help them and may face increased costs.

55. Agents on the whole anticipate both challenges and costs in implementing the proposals, ranging from initial research to analyse client portfolios for the timing and impact of MTDfB obligations, to the recruitment and training of additional staff and training and education programmes for clients. Some identified that the balance of their staffing would need to change to provide more bookkeeping support, and less tax return input work.

56. Inconsistency of workload was also seen to be an issue; with additional work making quarterly updates, the majority of submissions will be made in the latter part of the month. It was suggested that these would bring time pressures, as

many clients will have the same quarterly deadlines, with only a month to submit the updates.

57. Conversely, other agents anticipated a huge drop in income and the need to cut staff because they envisaged that more and more small business clients would start uploading their own figures and no longer use their services.

Government response

This is a combined response to questions 43 and 44.

58. The government recognises that MTDfB represents a significant change for some businesses and agents. HMRC is committed to delivering these changes in a way that works for businesses and agents.

59. Question 28 outlines the government's response to the concern around the proposed 9 month deadline for providing the end of year activity. The government will introduce legislation which will require that the end of year activity has to be provided by the sooner of 10 months after the last day of the period of account or 31 January of the year of assessment in which the profits for that period of account are chargeable to income tax.

60. HMRC does not want to disturb the professional relationship that exists between customers and their agents, but is clear that for some that relationship may change.

61. Although both agents and businesses anticipated that support would be needed on an ongoing basis to oversee the operation of their bookkeeping systems and assist with quarterly updates to HMRC, we believe that post-transition, both the digital record keeping and the automation of the update process (requiring only a check and send) update should be quick and easy. Many respondents already using digital tools to assist with their record keeping recognised this.

62. HMRC has already started piloting these changes before moving to more extensive live testing with a much larger group of businesses throughout 2017. HMRC will use the information and insight gained to further inform the impact assessment and to ensure that software products are both fully tested and offer the best experience possible, prior to the requirements coming into force.

63. Within the live-testing environment HMRC will also look at how it can tailor help and support to deal with the needs of specific sectors; HMRC will be including these groups within its beta testing to ensure it understands the specific impacts of MTDfB on these sectors. HMRC will also look at how it works with software providers to provide products to meet the needs of groups with specific needs.

Customer Journeys and Impacts Modelling

64. To understand how MTDfB would affect HMRC customers, we identified and mapped out, at a very high level, the key customer journeys that would cover the majority of the unincorporated business population. The mapping also considered the differing journeys that would be undertaken by those businesses that maintained largely paper-based records and those that already used digital tools such as record-keeping software.

65. We identified three main customer groups for the purposes of high-level customer journey mapping:
    - Sole Traders under Income Tax Self Assessment
    - Simple Partnerships under Income Tax Self Assessment
    - Unincorporated businesses subject to VAT.

66. We also considered a high-level agent journey. We did not consider more complex businesses or those subject to corporation tax because the policy design is subject to further consultation in 2017.

67. The customer journeys HMRC has mapped are reproduced below:

Fig 1- MTDfB process for businesses

How will MTDfB affect how businesses do their income tax?

Here we give a summary of how this works for businesses paying income tax.

Stage	What will I need to do?	Why do it this way?
1: Record keeping	You will keep your business records (including VAT records where needed) using MTDfB compatible software. Software will provide guidance and prompts to help you.	MTDfB compatible software will help you get your tax right.
2: Updating HMRC	The software will use your records to prepare your summary update to HMRC. Every quarter, your software will remind you to send your summary to HMRC. Once you have checked it, you will press the button to send the update to HMRC	MTDfB compatible software will make sending tax data to HMRC straightforward. It will save you time at year end.
3: End of year activity	MTDfB compatible software will prepare end of year figures from your quarterly updates so you can check them. You can make adjustments before sending to HMRC. You can also include any additional information not in your quarterly updates. You will have up to 10 months to complete end of year activity after the last day of the accounting period.	Software will help you by: Knowing our tax rules Making calculations from your quarterly updates to HMRC; and Filling in totals where possible

What about VAT?

Where possible HMRC will use one set of data to calculate VAT. You can choose whether to align your accounting periods for VAT and Income Tax so that you can do both at once. Or you can stagger them to spread the work out.

What about partnerships?

All partnerships will maintain records using MTDfB compatible software. Every quarter the nominated partner will submit the quarterly update. The nominated partner will undertake end of year activity and this will cover the whole partnership: individual members of the partnership will no longer need to report their profits or losses separately.

What will HMRC do with this information?

Quarterly updates will allow HMRC to estimate your tax position throughout the year and help you to understand how this is developing. MTDfB software will highlight any simple mistakes and alert you to them earlier, and direct you to specific guidance. Those submitting information on personal as well as business income will be able to review this in the digital tax account.

Fig 2 – MTDfB process for agents

How will MTDfB affect agents?

MTDfB is designed to integrate record-keeping into your client's day-to-day routine so you can focus on adding value in other ways. Here we describe how it will look for an agent working with a small unincorporated business.

Stage	What will I need to do?	Why do it this way?
1: During year	Your clients keep their business records using MTDfB compatible software. Their quarterly updates will be prepared based on the data they have captured in the software. Clients can choose when to share their records with you, whether throughout the year, just at end of year, or just when updates are needed. Adjustments can be made each quarter, or at end of year.	MTDfB compatible software will reduce year end activity by spreading simple record keeping tasks and incorporating them into routine business activity throughout the year.
2: End of year activity	MTDfB compatible software will prepare end of year figures from the quarterly updates so you can check them. At this point you can make any adjustments. You can also include any additional information not in the quarterly updates. There is up to 10 months to complete end of year activity after the last day of the accounting period.	Software will help you support clients; reduce end of year activity by putting everything in one place, spreading work through the year, and addressing issues early.

What does this mean for agents?

The system is designed to help your clients keep up-to-date records and stop work from concentrating at the end of year. Routine work will be either be built into the working day or done automatically. This will allow clients to focus on their business and smooth out agents' workloads.

68. To establish the impacts of MTDfB against each customer group we mapped the tax obligations for each step of the journey, from gathering information to submitting the final update. The mapping considered the differing journeys that would be undertaken by those businesses that maintained a largely paper-based record keeping system and those that already used digital tools such as record-keeping software. We then reviewed obligations for each customer journey using 'As-is' and 'To-be' positions, showing how each obligation would change under MTDfB. The 'To-be' assessments were based on our ongoing stakeholder engagement, better understanding of software capabilities and settled policy intent.

69. Detail on this methodology is in Annex B to this document. Annex C provides an updated assessment of impacts.

3. Next steps

Draft legislation

1. Draft legislation introducing MTDfB, to be included in Finance Bill 2017, has been published today, and HMRC welcomes any comments or observations. The draft legislation can be accessed through the link which has been placed on the same page from which this document can be accessed.

Other areas

2. HMRC will be carrying out further research on customers’ needs, especially in regards to help and support and in choosing the software that is suitable for their particular needs.

3. HMRC intends to share suggestions from respondents in relation to functionality for free software with software developers, on a broad basis, to inform their work in building software packages.

4. HMRC will consider in more detail the suggestions made by respondents in relation to support to make the transition to MTDfB easier for businesses. Final decisions will be made before legislation is laid later this year

5. In early 2017, HMRC will publish further details, including the security measures it expects software developers to build into the packages they will offer to enable taxpayers to meet their obligations under MTDfB between HMRC and the software industry.

6. HMRC will increase its activity to raise awareness amongst businesses, setting out what MTDfB will mean and helping them prepare for the changes, including the option to get involved in testing the new products ahead of their formal introduction.

Annex A: List of respondents

1 Stop Accountancy Ltd
A J Carter & Co
A Roden Ltd.
Accounting 4 Solutions Ltd.
Accounts Direct, Chester
Acorn Accounting for Business Ltd
Acorn Financial Solutions LTD
Actors Direct Ltd
AH Cross & Co
AIMS Accountants for Business
AJ Stead & Co Ltd
Akerue Ltd
Alasdair MacGillivray CA
Aldershot & District Omnibuses Rescue & Restoration Society
Anders Tax Ltd
Anthony G Thorne LLP
APS Accounting
Arc PLC
Argenta Private Capital Ltd
Artistes Taxation Services LLP
Aspect Accountants
Association of Accounting Technicians
Association of Circus Proprietors
Association of Convenience Stores
Association of Disabled Professionals
Association of Independent Professionals and the Self Employed
Association of Investment Companies
Association of Taxation Technicians
Atholl Scott Aberdeen
AW Tax Service Ltd
Barrowby Accountants Ltd
BDO
Beatons Group
Bee Friendly
Berkeley Associates
BHP Chartered Accountants
Bibby and Legge Limited Chartered Accountants
BJ Hammond & Co
Blinkhorns
Bradbury & Co Accountants
Brian Tilbury & Co
Brighter Futures- Nurture Outreach Consultant
British Dental Association
British Property Federation
British Red Cross
British Universities Finance Directors Group
Broadcasting Entertainment Cinematograph and Theatre Union
Broomfield & Alexander Ltd
Bullock Woodburn Ltd
Burges Salmon LLP
Burgess Hodgson CA
Buzzacott
Cameron Valentine Ltd
Campbell Stewart MacLennan & Co
Caseware
Caton Bookkeeping Services
Charity Finance Group
Charity Tax Group
Charles Bennett FCCA BSc Chartered Certified Accountants
Chartered Accountants Ireland
Chartered Institute of Public Finance and Accountancy
Chartered Institute of Taxation
Chris Edwards CA
CKLG Chartered Accountants
Clive McGovern Ltd
CMCGEE Ltd
CMF Pidgeon
Collins Accounts
Confederation of British Industry
Connaughton & Co
Conviso Ltd
Co-Operatives UK
CooperFaure Limited
Copson Grandfield CA
Country Land and Business Association Ltd
Courts & Co.
Crowe Clark Whitehill
Crunch
Daniela Bland and Co. Accountants
Dartmoor National Park Authority
David McQuillan & Company
David Smith Accountancy & Tax Specialist
Davies Tracey Chartered Accountants & Business Advisers

Deloitte
dhjh Tenbury Wells LLP
Dialogue Productions
Digital Advisory Group
Dinsdale Young Consultants Ltd
Disability Dynamics Ltd
DJJ Bradley AFA
DKS Chartered accountants
Dudley Gore & Co
Duncan & Toplis CA
Dyke Ruscoe & Hayes Ltd
Easterhay Ltd
Eaves & Co
Elizabeth Whiteley Accountancy Ltd
Entertainment Agents' Association Ltd
Equity
Ernst & Young
ESP Accountancy Ltd
Eudoxus Systems Ltd
exp2 Ltd
FBD Consultancy (Scotland) Ltd
Federation of Small Businesses
Federation of Small Businesses (Northern Ireland)
Fenn Cox & Partners
Fields & Co chartered accountants
Freeman Lawrence & Partners Ltd
FreeAgent
Garbetts (IOW) Limited
GBM Accounts Ltd
Geens Ltd
George Achillea Ltd
Gibson Whitter
Gillard Watson
Goodman Jones LLP
Gorman Darby & Co Ltd
Grace Gariff Associates
Greaves West & Ayre CA
Grow Your Business
Hackett Griffey LLP
Halesowen Press
Hampden Tax Consultants Ltd
Hanley & Co
Hart Parry
Hazlewoods LLP
Heacham House
Heelan Associates
High Path VAT Consultancy
Hillier Hopkins LLP
HMRC Charter Committee
Howsons
HPH CA
HPS Accountancy Limited
Hummingbird Accountancy Services Ltd
Humphrey & Co
Hutchcraft Accountancy & Taxation Services Ltd
Ian Couzens Chartered Accountants
Ian Critten Accountancy Ltd
IBC Accountants
Incorporated Society of Musicians
Ingham & Co CA
Institute of Certified Bookkeepers
Institute of Certified Practising Accountants
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
Institute of Financial Accountants
International Association of Book-keepers
Intuit
Investment Associations
IRIS
J Gareth Morgan & Co
J McGilvary Business Services
JD Accountants (Barnstaple) Ltd
JJ Accounts Ltd
JN Flanagan Tax Advice & Solutions Ltd
Johnston Carmichael LLP
JPS Accountants Ltd
JRR Accounting Ltd
K P Bonney & Co LLP
Kempster and Dale
Kendal Wadley LLP
Kingston Smith LLP
KLM Associates
KPMG LLP
Lambert Chapman LLP
Lamont Pridmore
Larking Gowen
Laurence Myears Chartered Accountants
Lemans CA
Leonard Bye Limited Chartered Accountants
Lesser and Co CA

Lieberman & Co Accountants & Registered Auditors
Linda Cotterill CA
Linklaters
Lloyd's
Llŷr James Cyfrifwyr Siartredig / Chartered Accountants
London Society of Chartered Accountants
Longhill Accounting Ltd
Low Incomes Tax Reform Group
Lymm tax services
M Holmes & Co
M&S Accountancy & Taxation Ltd
M. Seitler & Co
Mac Kotecha and Co
Madison Accountancy Services Ltd
Manchester Piano Tutor
McCabe Ford Williams Chartered Accountants
Menzies LLP
MHA MacIntyre Hudson
Moore & Smalley
Morris Owen
National Council for Voluntary Organisations
National Enterprise Network
National Farmers Union
National Federation of Retail Newsagents
National Landlords Association
National Union of Journalists
Nigel Webster & Co Chartered Accountants
Office of Tax Simplification
OPSIS Consulting
Patricia J Arnold & Co Ltd
Patricia McCartney Accountancy Services Ltd
Paul Alexander Knox Photography
Peter Saxton & Co.
Philip Nickson & Co Ltd
PKF Francis Clark
Plowden Facilities Ltd
Plummer Parsons
Powdin & Co Ltd
Prentis & Co LLP
Price Bailey LLP
Price Deacon Witham Ltd
Profile Learning Solutions
PWC
R & B Accounting Services
R.T. Marke & Co Ltd
Rayner Essex LLP
Rees Jeweller & Pawnbroker
Residential Landlords Association
Rhino Software Ltd
Richard Shephard Photographer
Richards & Co CA
Ridgell & Co
River Thames Accountancy Ltd
Rollinson Planning Consultancy Ltd
Rollo Burgess Accountancy Limited
Ross Martin Tax Accountancy
Roy Smart Limited
RSM UK Tax and Accounting Ltd
Saffery Champness
Sagars Accountants Ltd
SAGE
Saint & Co
Sandisons
Scottish Council for Voluntary Organisations
Sheppy Ltd
SHK Accountants Limited
Simon Hollingdale Accounts
Simple Accounting Ltd
Smith & Williamson
Smith Accounts
Southdown Accountancy Services Ltd
Sport and Recreation Alliance
Square Foot Solutions
Standard Life
Stationery Express
Steve Allen Entertainments
Sudworths Ltd
Summer & Co
Tasker Osman & Co
Tax Assist Accountants
TaxAid
Taxcalc
Taxwriter Ltd
Taylor Roberts Accountants
Thackeray Music Productions
Thandi Nicholls Ltd
The Act Store & Wasis Mgt Ltd
The Hutchinson Partnership Ltd
The Rowleys Partnership Ltd
Total Accounting Network
Trade Union Congress

Training for Employment
Trial Balance
Turl & Co Accountants
Türner & Co Ltd
UK 200 Group
UK Tax Practice Limited
Uley Tax Services
Ulster Farmers Union
W J James & Co Ltd
Walker Harris Chartered Accountants
Walter Wright Chartered Accountants
Waveney Bookkeeping
WH Prior
Wheatley & Co Certified Practising Accountants
Whitefield Tax Limited
Whittingham Riddell LLP
Wilson Accountants Ltd
Wolters Kluwer
Wood & Associates LLP
Woolford & Co
Working Men's Club
Zen Chartered Accountants & Business Advisors

Annex B - Impact Assessment Methodology

1. We have used the Standard Cost Model (SCM) methodology to estimate business impacts for the impact assessment. 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.

2. In looking at the ongoing (steady state) administrative burdens for businesses under MTDfB, 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.

3. The first step of this process was to identify the key customer journeys covering the majority of the unincorporated business population and how MTDfB will affect the time spent by customers in complying with their HMRC tax obligations.

4. We identified three main customer groups for the purposes of the model:
    - sole traders under Income Tax Self Assessment
    - Simple partnerships under Income Tax Self Assessment
    - Unincorporated businesses subject to VAT.

5. We did not, at this time, consider more complex businesses or those subject to corporation tax because the policy design for these areas will be subject to further consultation in 2017.

6. For each customer group we mapped each step of the journey from gathering information to submitting the tax return. We then applied the obligations within the SCM to each step. Rather than consider the 42 obligations that were applied to determine the initial Impact Assessment, we applied the full range of information and reporting obligations extracted from the SCM. 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 and submitting a VAT return.

7. We then reviewed these obligations for each customer group to understand how the MTDfB process would impact the customer journeys, comparing the 'as is' and 'to be' positions, taking into account that some businesses will already be using record-keeping and accountancy software, whereas others will be largely paper-based. Through ongoing stakeholder engagement, better understanding of software capabilities and settled policy intent we were better able to determine the impact of MTDfB changes between two positions that we had been able to do for the initial impact assessment.

8. The estimated reduction or increase in time was reflected in percentage terms and then applied across the unincorporated business population. With the SCM methodology allowing us to take into account different business sizes, reflect the fact that some businesses will already be using digital tools and will be using agents, the SCM methodology was then applied to apportion and average the impacts across each relevant business population segment. Changes in time for existing obligations are considered in conjunction with estimates of additional ongoing software costs, and the time needed to report quarterly to provide the overall administrative impact.

Annex C - Impact Assessment

HM Revenue
& Customs

Making Tax Digital

Who is likely to be affected

Businesses, self-employed people and landlords will be required to start using the new digital service:

From April 2018 if they pay income tax & NICs
From April 2019 if they are registered for and pay VAT
From April 2020 if they pay corporation tax

This will not apply to individuals in employment or pensioners, unless they have secondary incomes of more than £10,000 per year from self-employment or property.

In the consultation the government said that it was considering exempting more of the smallest unincorporated businesses from the requirement to keep digital records and make regular updates to HMRC. It was also considering deferring the mandatory start date of Making Tax Digital for Business (MTDfB) 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. Final decisions will be made before legislation is laid later this year.

General description of the measure

The government recognises that the majority of businesses want to get their tax right, first time, but the latest tax gap figures published by HMRC show that too many otherwise compliant businesses find this hard, even some who use an agent to help them. As a result over £8 billion a year in tax is lost from avoidable taxpayer errors.

This not only costs the public purse – it also causes businesses cost, uncertainty and worry when HMRC is forced to intervene to put things right.

HMRC wants to do more to help businesses get their tax right and MTDfB is a very important step in that direction. It will help businesses steer clear of avoidable errors, and give them a clearer view of their tax position in-year.

Businesses (including self-employed people and landlords) will keep records of their income and expenditure digitally, and send summary updates quarterly to HMRC from their software (or app).

Those who genuinely cannot get online due to their individual circumstances such as disability, geographical, or other reasons, will be exempted from these obligations.

Policy objective

MTDfB will bring the tax system into line with what businesses and individuals now expect from other service providers: a modern digital experience.

MTDfB will help businesses get their tax and NICs right first time. That will reduce the likelihood of errors, giving businesses greater certainty.

MTDfB is anticipated to take out around 10% of error on an ongoing basis, and give businesses a clearer view of their tax position in-year enabling them to plan to meet their tax obligations at minimum cost and minimum disruption.

Background to the measure

At Budget 2015, the government set out the vision for a transformed tax system and in December 2015 it 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.

On 15 August 2016, the government published six consultation documents, each focusing on specific customer groups or specific elements of the Making Tax Digital reforms.

Detailed proposal

Operative date

These requirements will apply to businesses' income tax and NIC obligations from April 2018, VAT from April 2019 and corporation tax from April 2020.

Current law

Income Tax Self Assessment for taxpayers was introduced in Finance Act 1994, 1995 and 1996 (coming into effect for the tax year 1996-1997) supplementing legislation contained in the Taxes Management Act 1970 (TMA). Since then a large number of sections and subsections of legislation have been added to TMA by subsequent Finance Acts, dealing with issues like, for example, corrections and amendments of returns by HMRC and customers respectively.

Various Directives, notably the Principal VAT Directive (2006), govern VAT law in the EU.

The Directives are given effect in the UK mainly by the Value Added Tax Act 1994 as amended by subsequent Finance Acts, with most of the provisions on the administration, collection and enforcement of VAT set out in Schedule 11 to that Act. But there are many detailed rules in Statutory Instruments.

Proposed revisions

Legislation will be introduced in Finance Bill 2017 that will set out:

Digital Record Keeping - How to keep digital records of trading and transactions and categorise expenses with help from prompts and guidance from their software.

Establishing Taxable Profit - how MTDfB would help establishing taxable profit. In particular, exploring when businesses and individuals should record accounting and tax adjustments for the purposes of arriving at a taxable profit and how business should reflect reliefs and allowances.

Providing HMRC with updates - how businesses and individuals would provide HMRC with quarterly updates under MTDfB. In particular, the level of detail the updates must contain, the time periods the updates cover and when they should be submitted.

'End of year' Activity - 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.

Summary of impacts

Exchequer impact (£m)

2016 – 17	2017 - 18	2018 - 19	2019 - 20	2020 - 21
-	-	+10m	+310m	+625m

The MTD changes will contribute £945 million to the Exchequer by 2020 - 21. This costing was certified by the Office for Budget Responsibility (OBR) at Autumn Statement 2015 and updated at Budget 2016. This costing will be updated again at Budget 2017. Based on latest tax gap estimates, receipts information, and including an additional year (2021-22), HMRC now expects MTDfB to bring in around £2 billion by 2021- 22. This updated estimate will be published in Budget 2017.

The estimates represent net tax gap savings arising as a result of more timely and accurate record keeping. These revenue benefits are calculated following the general approach that is:

revenue benefit = tax base x proportion of tax base covered x behavioural response.

The latest tax gap figures show the amount of revenue lost due to error and carelessness is now £8.7 billion (for 2014-15), an increase of £0.5 billion on 2013-14. To calculate the revenue benefit, assumptions were applied to break down the tax gap into revenue lost from small businesses within the scope of MTDfB, and due to errors and failing to take reasonable care. These were then projected forward to 2020 to 2021 by assuming that the relevant part of the tax gap will grow in line with the OBR's forecast tax liabilities. The government will publish the updated costing based on the £8.7 billion figure at Budget 2017 and project forward to 2021 to 2022.

Take-up rates were estimated based on the phased introduction of the changes, that is, IT and NICsfrom April 2018, VAT from April 2019 and CT from April 2020.

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.

There are three direct tax random enquiry programmes which are used to produce tax gap estimates. They cover:

- Self Assessment individuals and small partnerships
- Small and medium-sized enterprises
- Corporation tax for small and medium-sized enterprises

Random enquiry programmes allow HMRC to estimate the extent of under-declaration of liabilities arising from the submission of incorrect returns. Each return selected is subject to a full enquiry involving a complete examination of books and records.

Economic impact

This measure is not expected to have any significant macroeconomic impacts.

Impact on individuals, households and 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.

The government recognises that many people with disabilities use digital technology and are able to interact online using assistive technology. HMRC will ensure that available software will be compatible with forms of assistive technology and that those that are willing to operate MTDfB are able to do so.

Ofcom's 2016 statistics indicate that 59% of homes now own a tablet device and 71% of UK adults now have a smartphone. 97% of small and medium-sized businesses have access to online services. Although it is expected that the digitally excluded population will be relatively small, some of the segments impacted by the changes may be disproportionately represented within this population.

Individuals 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[6].

[6] See government response to question 34

Impact on business including civil society organisations

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 (including around 900,000 landlords), 1.6 million companies, over 400,000 ordinary partnerships, 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 help businesses to manage their affairs more effectively.

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 meeting their tax obligations, and move the focus away from time-consuming activities such as gathering and inputting data and more towards reviewing the updates that the software has generated and making any amendments.

It is expected that these changes will also affect agents acting for businesses. Some businesses may find the new MTDfB software means that they can do more in relation to record keeping and tax. Some businesses which currently use agents and are recording income and expenditure digitally may choose to make the quarterly updates themselves. With software categorisation of income and expenditure, final end of period activity should be a simpler process than it is currently for a business maintaining their books and records on paper. Routine work will done automatically. This will allow both agents and their clients to focus on higher value business activities.

Individual partners in a partnership will no longer have to separately provide HMRC with details of their share of the profits or losses from the partnership.

They may therefore save agent fees at year end where they previously required an agent to make the return.

Once businesses have transitioned to regular digital record keeping, the obligation to provide quarterly updates to HMRC is expected to result in an overall reduction in burdens compared to the current once a year reporting requirements.

Our analysis of the ongoing impact on administrative burdens uses the Standard Cost Model (SCM). 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.

The assessment brings into the model the full range of tax and NICs obligations covering the majority of the unincorporated business population.

Changes in time for existing obligations are considered in conjunction with estimates of additional ongoing software costs, and the burden of quarterly updating, to provide the overall administrative burden impact.

Once all businesses complying with MTDfB have fully transitioned, and are making full use of software capabilities, steady state savings associated with an overall reduction in time spent complying with existing ITSA and VAT obligations, plus the complete removal of certain obligations, are estimated at £270 million.

The SCM provides the estimated costs for a proportion of businesses incurring ongoing software and external agent costs as a result of complying with these obligations, and until behavioural responses to MTDfB are better understood, these costs are maintained at current levels. Costs are then estimated for increased software subscription costs, and making quarterly updates. Steady state costs are estimated at £170 million.

This produces a net admin burden saving of £100 million (steady state in 2021-22).

HMRC has profiled these estimates using take-up assumptions over the period from 2017 to 2018 to 2022 to 2023.

Estimated costs depend on final software solutions, the availability of free software and individual providers' pricing structures. The government recognises that this produces a broad estimate, and so we will review and test this analysis and our assumptions through ongoing extensive engagement and consultation with businesses, and through further research and analysis.

This means that the final estimate of the savings and costs to business could be different from the estimate presented here.

It is also expected that businesses will incur transitional costs in moving to the new arrangements. Our current estimate is that the transitional costs average about £280 per business over the period 2017-18 to 2020-21.

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 and 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
- additional accountancy / agents costs

The assessment of the MTDfB impacts over the 4 year period to 2022-23 is below:

Current breakdown of Admin Burden costs and savings (all £m)

Profile (£m)	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Steady-state costs	-	£100	£170	£170	£170	£170
Admin Burden savings	-	-£40	-£200	-£270	-£270	-£270

Transitional costs (one-off)	£100	£500	£350	£30	-	-
Net impact	£100	£570	£320	-£70	-£100	-£100

The presented figures have been individually rounded to the nearest ten million and therefore may not sum to the net burden impact.

The above table indicates that although businesses will see costs in the first transitional years, savings will be made from 2020-21 onwards.

Transitional costs may be lower for businesses already using digital tools or are eligible to use free software. For those business that have limited existing digital capability and/or need to purchase hardware and software, costs may be higher.

Quantitative estimates of the one-off transitional costs and ongoing savings will continue to be developed through ongoing research and consultation with businesses to ensure that these are reflective of the final software solution and MTDfB policy design.

Small and micro business assessment:

The MTDfB changes will improve the quality of record keeping, reducing the likelihood of mistakes (and attendant risk of unwelcome and costly HMRC compliance interventions) and help businesses to manage their cashflow more effectively. In the longer term, we anticipate a reduction in administrative burdens for these businesses.

The government recognises by their very make-up that this group includes businesses which 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 requests for help and support from the less digitally engaged individuals and business in transitioning to the new requirements.

The number of businesses and individuals affected and the impacts on them will be reviewed in light of the consultation responses received and throughout 2017 as large scale piloting takes place in advance of MTDfB's mandatory introduction.

Operational impact

MTDfB builds on HMRC's existing digital services for businesses, including the business digital tax account that is already available to all 5.4 million small businesses.

From April 2018, businesses in scope (including sole traders and landlords) will be required to keep their records digitally and update HMRC quarterly with summary data from their software. HMRC will need to develop a customer support model to help businesses that need their help with the transition.

The details of the proposal will be developed during the large scale pilot, therefore it is not possible to provide further details of the impacts on HMRC at this stage.

Other impacts

Other impacts have been considered and none have been identified.

Tax Information & Impact Note

Updated estimates of impacts will be included in the Tax Information & Impact Note that will be published alongside draft legislation.