

# MAKING TAX DIGITAL REFORMS AFFECTING BUSINESSES THE INCOME TAX (DIGITAL REQUIREMENT) REGULATIONS

Response by the Association of Taxation Technicians

## 1 Introduction

- 1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the Income Tax (Digital Requirement) regulations<sup>1</sup> ('the regulations') published on 13 September 2017.
- 1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.
- 1.3 Our comments follow the order of the regulations.

## 2 Consistency of terms – recording, keeping and preserving

- 2.1 In the primary legislation for *Making Tax Digital for Business* (MTDfB), paragraph 11 of the new Schedule A1 TMA 1970 (inserted by Clause 60 of the Finance Bill [2017-2019]) refers to *keeping* and *preserving* records in electronic form. We are taking *keep*, in this case, to mean the entry or recording of transactions as they arise. The requirement to retain these records for a longer period of time is indicated in paragraph 11 by the word *preserve*.
- 2.2 Regulation 2 comprises the interpretation clauses. In this regulation 'functional compatible software' is defined as having the function of *recording* and preserving records, rather than *keeping* and preserving. These terms are repeated in regulation 3. However in regulation 5 'Keeping and recording digital records', the language reverts to '*keep* digital records'.
- 2.3 More consistent language would be helpful to clarify if *keep* is intended to mean the retention for a period, or the actual recording of data. *Recording* may be a more useful term in respect of MTDfB obligations but it involves a departure from the language of the primary legislation.

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<sup>1</sup> <https://www.gov.uk/government/consultations/making-tax-digital-reforms-affecting-businesses>

### 3 Requirement to use functional compatible software

- 3.1 Regulation 3(2) requires digital records to be preserved for a period as required by s12(B) of TMA 1970. How will this work in practice and has this been addressed with the software houses? One software house website suggests that data on their cloud accounting system is currently available for a year post cancellation of subscription on a read only basis which would not be sufficient period of time. Another provider says that data is archived but the period of retention and details of customer access rights are not specified.
- 3.2 Where a business has been paying a monthly subscription for cloud software, will they be required to keep paying for access for the post-cessation period, or will it be acceptable to download and retain data? Once outside the software package it may not be as easy to extract any required information from the archived data. Equally, presumably it is possible for the APIs themselves to be updated over time, which may create compatibility issues for older data.
- 3.3 Given the pace at which software changes and the relatively short life of much hardware, there is a risk that data held electronically will not be accessible throughout the preservation period – either because software is out of date, software providers have ceased to trade, hardware failure, loss/corruption of memory sticks etc. In our view the regulations should cater for post-cessation compliance through a low or, ideally, no-cost method.

### 4 Digital Start Date for Partnerships with property income

- 4.1 Regulation 4 defines the date of entry into the digital record-keeping regime for a *relevant entity*. A *relevant entity* which is a property business, or a business containing a property business, will have a 6 April start date in the first tax year the rules apply. This reflects the general position that property income is taxed on a tax year basis. For all other businesses, the digital start date is linked to the accounting period, which may or may not coincide with the tax year end.
- 4.2 Trading partnerships which have an element of rental income, and a year-end which is not aligned with the tax year, may be following HMRC guidance at PIM1040. This guidance allows such partnerships to draw up the property business element to the accounts year end, and not the tax year end. In circumstances where the guidance in PIM1040 currently applies, does regulation 4 mean that the whole of the partnership business would be brought into digital record keeping at a 6 April start date because it contained a property business, or would continuing PIM1040 treatment mean that the inclusion of the property business could be ignored so that the digital start date for the whole business was determined by the accounting period?
- 4.3 In a similar vein, what is the position where a business is letting temporarily surplus trading premises in circumstances where the guidance in PIM4300 applies? This guidance allows such rental income to be treated as part of the trade, so does this mean that for regulation 4 the digital start date can be determined by the accounting period?

## 5 Ceasing to keep records digitally

### 5.1 Regulation 5(1) states that:

*“A relevant entity must keep digital records for each business for the period on and from the digital start date which applies to the business until the date on which the business ceases [emphasis added].”*

There will be cases where digital record keeping requirements will end prior to business cessation. For example, a business could move from an area with good broadband to one with insufficient or no broadband. The business will then become digitally excluded for current and future *information periods* until the exclusion ends.

### 5.2 The definition of *relevant entity* includes that the entity is not subject to the exemptions from digital requirements set out in regulations 24 to 26. We assume that if one of the exemption conditions is met at a date after the digital start date, then the entity ceases to be a *relevant entity*. The requirement for keeping digital records will end for the entity for the first *information period* in which it is exempt from digital requirements.

### 5.3 We propose that for clarity after ‘business ceases’, the following wording is added: ‘*or, the entity becomes eligible for an exemption and so ceases to be a relevant entity.*’

### 5.4 It would also be helpful to clarify if ‘business ceases’ is intended to mean the cessation of trading, or whether digital record keeping is required during the run-off period post the cessation of trade in which, for example, the final debtors are collected and creditors paid.

## 6 Timing of recording/keeping digital records

### 6.1 Regulation 5(2) and 5(3) require that the transactions in a quarterly report are recorded in the digital software prior to the quarterly submission date. This is consistent with the stated intention of MTDfB to encourage businesses to record transactions on a timely basis to reduce errors.

### 6.2 If a business has recorded the transactions in a timely manner, but failed to submit their quarterly update on time, how will compliance with regulation 5(2) and 5(3) be tested? Where a business uses software, they will need to ensure that it has an audit trail functionality to track data entry. Where a business is recording underlying data on an excel spreadsheet, as is currently permitted subject to the use of further software to interact with HMRC via API, the business may struggle to prove that this requirement has been met. The point is given sharpened relevance by the significant difference between the sanctions for failing to keep records digitally (paragraph 12 of Sch A1) and those contemplated for late submission of a quarterly update<sup>2</sup>.

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<sup>2</sup> See HMRC consultation Making Tax Digital: sanctions for late submission and late payment (20 March 2017) at: <https://www.gov.uk/government/consultations/making-tax-digital-sanctions-for-late-submission-and-late-payment>

## 7 Update Notices

- 7.1 We note that regulation 8 allows for further provisions to be laid out in notices.
- 7.2 Our first concern is that the use of notices within direct taxation is almost (if not completely) unknown. (By contrast, taxpayers and their agents are familiar with the need to refer to notices in relation to VAT.) Introducing a major change in what constitutes legislation at the same time as mandating radical changes in the form of business records seems to involve an unnecessary complication. If at all possible, we think that the whole of the MTD legislation should be contained within primary legislation or statutory instruments. In passing, we observe that the draft notice published on 13 September 2017<sup>3</sup> contains a particularly confusing mixture of general background information and obligations. We are concerned that the importance of notices designed in that manner may not be properly appreciated.
- 7.3 Our second concern in relation to the use of notices is that they may lack the precision required of primary and secondary legislation and so lead to uncertainty.

## 8 Digital Exclusion Exemption

- 8.1 Regulation 24 requires that for a partnership to be digitally excluded **all** the partners must be digitally excluded, regardless of the role that each partner plays in the business. Our concerns are that:
- Where a partner is digitally excluded, but the partnership as a whole is not, the requirement for the partnership to keep digital records will mean that any digitally excluded partner will be unable to maintain or access the partnership's tax and accounting records
  - Where the digitally excluded partner or partners are those who deal with the financial affairs of the partnership business, the inclusion within the partnership of any partner who does not meet the digital exclusion condition will mean that the partnership cannot satisfy the exemption condition. This appears to be the case even if the digitally capable partner's role in the business is very different from, and unrelated to, the recording or reporting of the partnership's financial affairs.
- 8.2 The regulations are consistent with the legislation included in Clause 60 of the Finance Bill 2017-19 and we have previously made a formal submission<sup>4</sup> to the Public Bill Committee raising the points above and presenting some examples of where the provisions as currently drafted may operate in a discriminatory manner.

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<sup>3</sup> See: Income Tax Notice XX: Retail Sales, Update Information, End of Period Information and Partnership Information at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/644228/Income\\_Tax\\_Digital\\_Requirements\\_Regulations.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/644228/Income_Tax_Digital_Requirements_Regulations.pdf)

<sup>4</sup> <https://www.att.org.uk/sites/default/files/171013%20Written%20evidence%20from%20the%20ATT%20-%20Digital%20Exclusion%20of%20Partnerships%20-%20Final.pdf>

## 9 Other exemptions - Income Exemption

9.1 Regulation 25 makes provision for exemption from the digital requirements where the person's qualifying income is less than a specified limit. This limit is yet to be set.

### 9.2 *Level of income exemption*

It has previously been suggested by HMRC that the income exemption exclusion will be set at £10,000. This is very low and is less than the 2017/18 personal allowance. Even without deducting expenses, the business owner may not be liable to pay tax unless they have other income. Setting such a low figure for the income exclusion will bring micro-businesses owners who are not liable to income tax into digital reporting. The benefits to either those involved or HMRC are not obvious.

We have previously raised this point in our response to the consultation *Making Tax Digital – Bringing Business into the Digital Age*<sup>5</sup>. The VAT limit would be a more sensible income exclusion limit. HM Customs and Excise no doubt gave considerable thought into the VAT threshold when it was first set and continues to give thought to its subsequent increases. To require interaction by the smallest businesses below the limit causes undue costs for businesses that can ill afford it. For these reasons we strongly urge HMRC to set a limit which does not cause either hardship or undue complexity for the UK's smallest businesses.

### 9.3 *Effect of the exemption*

The exemption is tested by looking back at the qualifying income arising in the tax year ending two years before the tax year in question. This is helpful as it ensures that at the point of the test, the individual should have determined their gross income for that tax year. For clarity, it would be helpful if regulation 25(3) could be amended to include the words in bold as follows:

“The exemption applies to a relevant period if the amount of the person's qualifying income for the tax year which ended two years before the **end of the** tax year in (or with) which the relevant period in question ends is not more than £[ ]”.

Where the individual was not in business in this tax year, the qualifying income is taken as nil. This provision appears to allow businesses a *period of grace* for them to prepare for digital record keeping. This is welcome, assuming that the limit is set at a reasonable level as noted about.

In the examples below, we set out our understanding of how regulation 25 operates, assuming in each case that the regulations themselves commence on 6 April 2020, with an exemption income level of, say, £20,000. If our conclusions are correct, is that the intended consequence in each case? If they are incorrect, do the regulations require amendment to avoid any apparent misunderstanding on our part?

9.4 **Case 1:** An individual commences in business on the 6 April 2020 having previously been employed. The qualifying income for tax years 2018/19 and 2019/20 is therefore nil as the individual was not

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<sup>5</sup> <https://www.att.org.uk/technical/submissions/making-tax-digital-att-comments>. See section 2.32 of *MTD Bringing Business into the Digital Age*.

running a business in these years. Following the test, we conclude that digital reporting requirements are delayed until the start of the 4<sup>th</sup> year of trading, when the business has been able to establish itself.

Tax Year	2020/21	2021/22	2022/23	2023/24
Qualifying income	£15,000	£60,000	£80,000	£80,000
Requirement for digital reporting in the tax year	No	No	No	Yes
Reason	Qualifying income in 2018/19 £nil	Qualifying income in 2019/20 £nil	Qualifying income in 2020/21 under £20k	Qualifying income in 2021/22 over £20k

Presumably where the business does not start on the 6 April, the usual commencement rules for income tax will be applied to ascertain the income in each period. The same business above, starting one month later on the 1 May 2020 with the same qualifying income figures to the 30 April each year, would come into digital reporting one year later.

9.5 But the rule also results in some unsatisfactory outcomes:

9.6 **Case 2:** An individual has a property portfolio which generates a qualifying income of £10,000 per year, every year. They also have a small amount of self-employment which earns a gross £5,000 per year. In 2021/22 they undertake a large, one-off contract and earn an extra £10,000 in self-employed income in that year. They are not otherwise digitally excluded.

Tax Year	2020/21	2021/22	2022/23	2023/24	2024/25
Qualifying income	£15,000	£25,000	£15,000	£15,000	£15,000
Requirement for digital reporting in the tax year	No	No	No	Yes	No
Reason	Qualifying income in 2018/19 under £20k	Qualifying income in 2019/20 under £20k	Qualifying income in 2020/21 under £20k	Qualifying income in 2021/22 over £20k	Qualifying income in 2022/23 under £20k

On this basis a one-off element of work brings the individual into digital reporting requirements for one year when, in general, they should be outside the scope. This will mean the individual incurs unnecessary time and expenditure in meeting digital record keeping requirements for one year. It would be beneficial if provision could be made for the individual to show that the *trigger year* was an exceptional event and it is not expected that the limit will be breached in future years.

- 9.7 **Case 3:** An individual has been self-employed for some time earning £40,000 a year but is now looking to reduce their work with a view to moving towards retirement.

Tax Year	2020/21	2021/22	2022/23	2023/24
Qualifying income	£40,000	£15,000	£5,000	£5,000
Requirement for digital reporting in the tax year	Yes	Yes	Yes	No
Reason	Qualifying income in 2018/19 of £40k	Qualifying income in 2019/20 of £40k	Qualifying income in 2020/21 of £40k	Qualifying income in 2021/22 under £20k

In this example, the individual has to continue with digital reporting requirements for two years in which they are below the limit. It would be beneficial if provision could be included that where the individual can demonstrate that the income has reduced and is expected to remain below the exclusion level (for example due to reduced activity) that the benefit of the exclusion could be taken sooner.

The rules will have a similar effect for regulation 26 which applies to partnerships.

## 10 Contact details

- 10.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Helen Thornley, on 07773 087125 or at [hthornley@att.org.uk](mailto:hthornley@att.org.uk).

Yours sincerely

Yvette Nunn  
Co-Chair of ATT Technical Steering Group

## 11 Note

11.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,000 members and Fellows together with over 5,700 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.