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TERTIARY LEGISLATION FOR MAKING TAX DIGITAL FOR INCOME TAX

Response by Association of Taxation Technicians

1 Introduction

- 1.1 The Association of Taxation Technicians ('ATT') is pleased to have the opportunity to provide comments on the draft notices (the 'MTD Notices') which would be made under regulations 3,8, 12 and 16 of the Income Tax (Digital Requirements) Regulations 2021 and which were published on 1 July 2022¹.
- 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 Overall, we find it very disappointing that HMRC have taken so long to produce the MTD Notices, and yet they are still lacking in important details. It is now nearly 10 months since the Income Tax (Digital Requirements) Regulations 2021 (the 'MTD Regulations')² which underpin the MTD Notices were laid, and yet the bulk of the material contained in them consists of lists of information copied across from the relevant Self-Assessment return pages.
- 1.4 While the MTD Notices helpfully clarify some points (especially regarding the contents of quarterly updates and the End of Period Statement ('EOPS')), there remain a number of essential, unanswered questions regarding how reporting under MTD for Income Tax Self-Assessment ('MTD for ITSA') will work in practice. For example, the notices are completely silent on the practical application of digital links, how digital record keeping and reporting will work for jointly owned property etc. There is also no indication of any possible relaxation of digital record keeping requirements, for example for amounts received by third party agents, petty cash etc. We would contrast this with the MTD for VAT Notice³ 700/22 which provides detailed, practical guidance to assist taxpayers and their agents in understanding their obligations.
- 1.5 We understand that further guidance will be published later this year which may help to address some of these outstanding areas of uncertainty. However, it would have been helpful to have this published, in draft at least,

¹ <https://www.gov.uk/government/consultations/tertiary-legislation-for-making-tax-digital-for-income-tax>

² <https://www.legislation.gov.uk/ukxi/2021/1076/contents/made>

³ <https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat>

at the same time as the MTD Notices. As it stands, we only have part of the picture, which makes it difficult to provide detailed comments on the practicalities of HMRC's proposed approach to MTD for ITSA compliance.

- 1.6 The MTD Notices comprise four separate notices – a Software Notice, an Update Notice, an End of Period Notice and a Retail Sales Notice. In sections 2 to 5 below we have set out our specific comments on each of these in turn. All legislative references are to the MTD Regulations unless otherwise stated.
- 1.7 We would be pleased to discuss any aspect of this submission further. Relevant contact details can be found in Section 6.

2 Software Notice

- 2.1 This notice is made under regulation 3, which states that a notice may be given which 'specifies conditions with which functional compatible software must comply'. It states, in summary, that any transfer, recapture or modification of a digital record in the functional compatible software must take place digitally and not manually.
- 2.2 The notice confirms that 'digital links' must be used for any transfer between software programmes that form part of the functional compatible software. However, it does not provide any practical information as to how this can be achieved in practice. We would therefore urge HMRC to bring out clear guidance as soon as possible which discusses this in more detail. In particular, this guidance should cover:
 - At what point the 'functional compatible software' begins, and the requirement for digital links starts? We continue to see confusion around this in MTD for VAT, for example where a specialist or legacy EPOS / accounting system is used which cannot easily be digitally linked.
 - How an agent can maintain digital links where information is transferred to and from clients.
 - The exact meaning of 'digitally' vs 'manually' – we assume this will be similar to MTD for VAT (for example copy/cut and paste is considered a manual transfer) but this needs to be confirmed, as different individuals may interpret these terms differently.
- 2.3 We also note that, in referring to 'transfer, recapture or modification', the Software Notice appears to go beyond merely requiring digital links between the various pieces of software in use. For example, the reference to modification could be read as indicating that any change to information recorded in the software, for example to correct an incorrectly recorded amount, reflect a disallowance etc., has to be performed digitally. It is not clear how this could ever work in practice, as we would expect such adjustments to be manually keyed into software. We would recommend that the emphasis in the Software Notice is instead placed on the need for digital transfers of data within the functional compatible software, as it is for MTD for VAT. Guidance should then separately address how any modifications of the digital records should be carried out in practice.
- 2.4 We believe that many businesses may struggle with implementing digital links, especially in the early years of MTD for ITSA, and note that the digital links requirement had a significant soft landing period under MTD for VAT. We would strongly encourage the introduction of a similar soft landing for MTD for ITSA, especially given the larger and more diverse population in scope.
- 2.5 Finally, we note that regulation 3(5) states that 'A software notice may specify different conditions for different cases or purposes'. There appears to be no sign of this flexibility being applied in the Software Notice, and we would encourage HMRC to explore whether the digital links requirements etc. could be simplified in specific cases, such as where property is jointly owned.

3 Update Notice

- 3.1 This notice is made further to regulation 8, and sets out the information which needs to be included in the quarterly updates submitted under MTD for ITSA. Different schedules of required information are set out for trading businesses, UK property businesses, overseas property and UK and EEA Furnished Holiday Lets ('FHLs'). We have set out below some general comments that apply across the whole Update Notice, as well as specific comments focusing on the requirements for trading businesses and property businesses.

General comments

- 3.2 The information schedules provided currently give very mixed messages as to whether tax and accounting adjustments are permitted, or even required, in quarterly updates.
- 3.3 We had understood that it would be possible for businesses to include tax and accounting adjustments in their quarterly updates should they wish, but that this would not be a requirement. However, the information schedules set out in the Update Notice do not appear to allow for these adjustments in the majority of cases, whilst at the same time specifically requiring some information to be provided that relates solely to accounting adjustments (such as depreciation and bad debts – see 3.12 below).
- 3.4 It is vital for HMRC to clarify their position regarding the role of tax and accounting adjustments in quarterly updates. Either no accounting or tax adjustments should be required, or they all should be (with our strong preference being the former). Having a half-way house where some adjustments are required, but others not allowed even if a business would otherwise wish to include them, will lead to confusion and limit the usefulness of the information received by HMRC. If the intention remains that tax and accounting adjustments are purely optional in quarterly updates, then this should be reflected in the Update Notice. Anything which represents tax or accounting adjustments should be removed from the schedules of required information, with guidance instead setting out how these can be incorporated for those who choose to do so.
- 3.5 We further note that the Update Notice does not make it clear on what basis – cash or accruals – information is to be provided, leading to further confusion. We had understood that businesses could use the basis normally used to prepare their tax return. This should be confirmed in the Update Notice, with guidance setting out what businesses need to do where they change the basis for their accounts (i.e. from cash to accruals basis or vice versa) from one period to the next.

Simplified reporting for businesses below the VAT threshold

- 3.6 The Update Notice provides for businesses below the VAT threshold to provide simplified quarterly updates giving a total of their income and expenses, without the requirement to split these by category (similar to the existing 'three-line accounting'). Whilst this is a welcome simplification in principle, especially for the very smallest businesses, we note that it will limit the usefulness of the information made available to HMRC and potentially in turn the support which can be given to taxpayers. For example, it will, presumably, limit the nudges and prompts which can be replayed to the taxpayer under MTD for ITSA.
- 3.7 We assume that this relaxation will apply equally to the digital record keeping requirements for eligible businesses, such that individual transactions do not need to be categorised but can simply be reported as an income or expense. This appears to follow from regulation 6, which imposes a requirement to record the 'category' of a transaction, but goes on to note that 'a transaction falls within the category of transaction applicable to it which may be specified in an update notice which exists at the date of the transaction'. This would appear sensible, as if businesses are required to categorise transactions in their digital records anyway

it would not represent a real simplification to allow them to report only totals of income and expenditure in their quarterly updates. Regardless of approach, the position should be confirmed in the guidance issued by HMRC later this year.

- 3.8 Further information is also required in relation to the application of the VAT threshold to this relaxation. In particular, what year the test should be applied to, and what measure of turnover is to be used? We understand that the reference to turnover here is to total turnover, and not VAT taxable turnover (i.e. it will include items which are exempt or outside of scope of VAT). This should be clearly stated in the Update Notice, as otherwise there could be confusion, especially amongst businesses who are not registered for VAT solely because they make predominantly exempt supplies. The Update Notice, or accompanying guidance should also clarify the position where an individual has more than one trade or property business – is total turnover across all of these compared to the VAT threshold, or can this be done separately for each reporting requirement?
- 3.9 Thought also needs to be given as to what happens when a business moves from below to above the VAT threshold during a period. For example, if a business has previously traded below the VAT threshold, but then subsequently exceeds the threshold during the tax year due to receiving unexpectedly high income in quarter 4, does the business have to refile the simplified quarterly updates already submitted for that year (and potentially recategorise its digital records)? Or can it just proceed to report the full quarterly update information from the start of the following tax year?

Trading businesses

- 3.10 We note that the information required for businesses with trade profits closely mirrors that requested in SA103F. This is a welcome starting point, as these categories will already be familiar to businesses and their agents.
- 3.11 However, there are a number of figures requested in the SA103F which are typically only charged or calculated annually, and may therefore not lend themselves to reporting on a quarterly basis. For example, with interest on bank and other loans, are businesses intended to record merely the amount actually paid in the quarter, or is some estimate of what has accrued required? Similarly bank and credit charges and insurance premiums may only be payable annually – is it sufficient to just report these in the quarter they are paid, or must some apportionment take place?
- 3.12 The Update Notice indicates a requirement to report depreciation and irrecoverable debts written off in quarterly updates. We do not believe that these should be a required category for quarterly updates, as they are purely accounting adjustments and not business transactions. In addition, depreciation in particular is often only calculated at the year end. Are HMRC expecting businesses to make these adjustments in year for each quarter? As noted at 3.4 above, excluding the majority of accounting adjustments, but requiring businesses to include others is likely to cause confusion. We would therefore strongly recommend dropping these items from the list of required information in the Update Notice.

Property businesses

- 3.13 The Update Notice discusses four distinct types of property business:
- UK Property (not UK or EEA Furnished Holiday Let (FHL))
 - Overseas Property (not EEA FHL)
 - UK FHL
 - EEA FHL

Will separate quarterly updates need to be submitted for each of these? If so, this needs to be clearly stated in the Update Notice. If it is the case, then the treatment of expenses which may span more than one of these categories (for example landlord's insurance or agents' fees which cover both FHL and non-FHL properties held by a single individual) will need to be carefully considered. There may also be practical difficulties in identifying in-year whether or not a particular property qualifies as an FHL. A pragmatic approach here would be to allow quarterly reporting to follow the position in the previous tax year, without having to worry about whether or not the various tests are likely to be met in the current year.

- 3.14 As with trading businesses, we note that the information requested in the Update Notice generally mirrors that in the SA105 and SA106. Again, we view this as a sensible starting point, but note that figures included in the SA105 or SA106 which are often only paid or calculated annually may not easily map across to quarterly reporting. For example, annual expenses such as insurance and ground rent are included in the information required - is an apportionment of these expected, or can they just be included in full in the quarter they are paid?
- 3.15 We also note that, in some instances, income is split out more in the Update Notice than it currently is in the SA105. For example, for UK property, total rents and other income are listed separately in the Update Notice, but are all reported together in box 5 in the SA105. Unless there is a pressing reason for these amounts to be recorded separately we would recommend that they instead mirror the SA105, in order to limit the changes needed to existing record keeping arrangements.
- 3.16 As discussed at 4.10 below, the treatment of residential property finance costs across the quarterly updates and End of Period Statement ('EOPS') is unclear. The required information in the Update Notice for UK property includes a specific category of 'residential property finance costs', despite the fact these will be disallowed in full in calculating the taxable profit / loss. Are HMRC expecting this disallowance to be reflected in the quarterly updates, or can the full interest charge just be reported each quarter? We also note that, in practice, many taxpayers may find it difficult to split out their mortgage repayments into capital and interest on a quarterly basis, especially if their lender does not provide detailed breakdowns on a regular basis.
- 3.17 All four types of property business have a requirement for 'other allowable property expenses' to be reported in quarterly updates. Whether or not something is allowable or not is a tax judgement, and as discussed above we had understood that tax adjustments are optional, but not required in quarterly updates. Are HMRC expecting businesses to undertake a review of what is allowable / disallowable on a quarterly basis? If so this will significantly increase administrative burdens and add cost. To avoid this, we would recommend that this category be renamed 'other property expenses' (in the same way there is a category of 'other business expense' for trading income), with any disallowances only required to be reflected when completing the EOPS.

4 End of Period Notice

- 4.1 This is a notice made under regulation 12, setting out the information to be included in the EOPS. Different schedules of required information are given for trading businesses, UK property businesses, overseas property and UK and EEA Furnished Holiday Lets (FHLs). Below we have set out some general comments that apply across the whole notice, as well as specific comments focusing on trading businesses and property businesses.

General Comments

- 4.2 Our understanding of the EOPS process is that this will bring together the income and expenses reported in the quarterly updates, before then overlaying any tax or accounting adjustments required to arrive at the

taxable profit / loss for the trade or property business. The actual tax liability will then be calculated as part of the final declaration process.

4.3 However, we note that the relationship between the EOPS and final declaration is not addressed anywhere in the MTD Notices. As a result, at first glance it would appear that several important pieces of information are missing from the End of Period Notice. That includes items which would be set against the eventual tax liability (rather than deducted in arriving at taxable profit / loss) such as foreign tax credits, construction industry scheme deductions and the basic rate tax reducer for residential finance costs. We assume that these will be reflected in the final declaration, but this needs to be drawn out clearly in the MTD Notices and guidance.

4.4 The End of Period Notice states that

“Where a relevant person has not already decided whether the amounts included in each expense category of transaction set out in the Update Notice include any elements which are disallowable, the relevant person must remove any disallowable expenditure prior to providing the EOPS total for the relevant period.”

This indicates that it must be possible to include disallowed amounts in quarterly updates. As discussed above at 3.4, if this is the intention it should be made clear in the Update Notice. This statement also raises further questions, such as whether it is possible to make adjustments for non-taxable income, or claim capital allowances in the quarterly updates. If the intention is that tax adjustments can be made in the quarterly updates, then the facility should be provided for all such adjustments to be made. For this option to be valuable to taxpayers and HMRC, it needs to be all or nothing, i.e. whilst businesses are not required to include tax adjustments in the quarterly updates, should they wish to they can make all available adjustments. A half-way house in which some adjustments can be made but not others will confuse taxpayers, produce inaccurate estimates and make reconciliation by HMRC difficult.

Trading businesses

4.5 We note that the categories requested in the EOPS for a trading business are taken mainly from the SA103. However, there are a number of categories included in the SA103 which are not replicated here, but which we believe should be, including:

- Allowance for small balance of unrelieved expenditure (box 24 in SA103S)
- Goods and/or services for your own use (box 60 in SA103F, box 27 SA103S)
- Non-taxable income (box 62 in SA103F)
- Loss brought forward from earlier years set off against this year’s profits (box 74 in SA103F, box 29 in SA103S) (we note this information is required for property businesses in the notice, but not trading businesses).
- Trading income allowance (box 16.1 SA 103F, box 10.1 SA103S) (we note the property allowance is included for property businesses in the notice, but the trading allowance is absent for trading businesses).

4.6 The End of Period Notice provides no clarity over how the EOPS will be structured after Basis Period Reform if a business doesn’t have a 5 April or 31 March year end. For example, there is no mention of the additional information that may need to be provided in the EOPS regarding apportionment from two accounting years, or how figures are to be adjusted to reach the final trading profit figure. There also appears to be nowhere on the EOPS to capture transitional profits brought into account, which may extend out to the first four years of MTD where a taxpayer has taken advantage of the full five year spreading period available. This needs to be urgently addressed.

4.7 Finally, we have the following suggestions as to how the presentation of the information schedule for trading businesses could be improved:

- We believe the reference to ‘Customers’ Premises Renovation Allowance’ should actually be to ‘Business Premises Renovation Allowance (‘BPRA’) and would suggest the wording is amended to reflect this.
- The last four bullet points (zero emissions car allowance, electric charge point allowance, structures and buildings allowance (‘SBA’) and Freeport enhanced SBAs) should be moved up the list to come below ‘zero-emissions goods vehicle allowance’ so that all capital allowances are kept together.

Property businesses

4.8 As with the Update Notice, the End of Period Notice discusses four distinct types of property business:

- UK Property (not UK or EEA Furnished Holiday Let (FHL))
- Overseas Property (not EEA FHL)
- UK FHL
- EEA FHL

It is not clear whether a separate EOPS will need to be submitted for each of these. This should be clarified in both the End of Period Notice and accompanying guidance.

4.9 As mentioned at 3.16 above, more clarity is needed over the treatment of residential property finance costs in the EOPS and quarterly updates. Whilst these are included as a required category in the Update Notice, no equivalent category is included in the End of Period Notice. Presumably this is on the basis that they should be excluded from the EOPS entirely as disallowed expenditure, with the basic rate tax reduction then being applied as part of the final declaration. However, this needs to be confirmed and explained in guidance.

4.10 We also have the following comments on the presentation of the information schedules for property businesses:

- As for trading businesses, we believe the reference to ‘Customers’ Premises Renovation Allowance’ should actually be to ‘Business Premises Renovation Allowance (‘BPRA’) and would suggest the wording is amended to reflect this.
- The property income allowance and rent a room exempt amounts should be moved up so that they appear above all other expenses and directly below income.
- Capital allowances seem to be treated very differently for the various types of property business – for example zero emissions goods vehicles are split out for UK and overseas but no other allowances (despite them not even appearing in the SA105). Is there a reason for this difference?

5 Retail Notice

5.1 This is a notice made under regulation 16 which allows retail businesses to keep a single digital record of daily gross taking for their retail sales.

5.2 This appears to be a sensible relaxation, which will benefit retailers making a significant number of sales each day. Guidance will however be needed as to how the phrases ‘retailer’ and ‘retail sales’ are to be interpreted for these purposes. Whilst some businesses, and their sales, will clearly fall into these categories, the position may be less clear for others. For example, would a veterinary practice which also sells medicines, special feeds, flea treatments etc. qualify as a retailer and be allowed to record daily gross takings for those sales?

- 5.3 We note that the Retail Sales Notice sets out a list of items which may be 'excluded when calculating the amount of daily gross takings'. This includes a number of income sources, but also refunds to consumers. It is unclear how this instruction to exclude refunds is to be interpreted. Does this mean (as would seem sensible) that refunds should be netted off in coming to daily gross takings? Or does it mean that refunds should not be taken into account? We would recommend that the wording here be clarified, and the point drawn out in guidance.

6 Contact details

- 6.1 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, Emma Rawson on 07773 087111 or erawson@att.org.uk.

The Association of Taxation Technicians

7 Note

- 7.1 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 more than 9,000 members and Fellows together with over 6,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.