# Making Tax Digital

A guide for clients – May 2017

## Introduction

The HMRC initiative 'Making Tax Digital' (MTD) intends that by 2020 the vast majority of businesses, self-employed people and landlords will have to keep track of their tax affairs digitally and update HMRC at least quarterly via their digital tax accounts.

## Current timescales

With the General Election coming in June 2017, the Government has however set aside some of the more controversial items, including MTD, from its Finance Bill temporarily.

**However the Treasury has indicated that MTD will be back on the table after the Election and our view is that businesses large and small should still prepare for change.**

### April 2018

This is the Making Tax Digital go live date for unincorporated businesses and landlords who pay Income Tax and who have a gross turnover in excess of the VAT registration threshold limit.

The VAT registration threshold limit is due to rise to £85,000 on 1 April 2017 and may well have risen again by April 2018. Any such announcement is likely to be made in the Autumn Budget 2017.

### April 2019

This is the Making Tax Digital go live date for unincorporated businesses and landlords who pay Income Tax and who have an annual gross income of more than £10,000 and are trading below the VAT registration threshold limit.

April 2019 is also the Making Tax Digital go live date for VAT. Businesses who are registered for and pay VAT, will be required to report their VAT return information through MTD.

### April 2020

Incorporated businesses, in other words Limited Companies, will be brought into Making Tax Digital from 6 April 2020. This is the Making Tax Digital go live date for Corporation Tax.

Very large partnerships with a turnover in excess of £10m are also likely to enter Making Tax Digital at this time

## Why is it changing? HMRC claim this will:

- Create a tax system that is more effective, efficient and easier for taxpayers by eliminating the burden of annual tax returns
- Simplify accounting for more businesses by allowing them to account for tax on a cash in and cash out basis
- Ensure customers have confidence that their tax return is right, allowing them to plan their cash flow more effectively

## Concerns

The scale and speed of the proposed changes has prompted concern from all sectors. There is a very real risk of the unwary giving HMRC grounds for investigations though inconsistencies and also that tax relief claims may suffer, not to mention the stiff penalties to be introduced for non-compliance after a teething period.

**Making Tax Digital: How does it affect businesses?**

Millions of businesses already manage their tax digitally: 98% of Corporation Tax returns and 99% of VAT returns are submitted online, and HMRC has delivered digital accounts to millions of small businesses.

## What is claimed as the benefits of MTD?

Businesses should not have to wait until the end of the tax year or even longer before knowing how much tax they should pay. HMRC will collect and process information affecting tax in as close to real time as possible, to stop tax due or repayments owed from building-up. The only real concession to the consultation was to allow continued use of spreadsheets providing they use embedded software to allow MTD. But this only creates yet more questions – what is that software, who will develop it, and how will it work at what cost.

Businesses will be required to use digital tools, such as software or apps, to keep records of their income and expenditure. Once the software has compiled the relevant data, businesses or their agents will feed it directly into HMRC systems via their computers or smartphones. Updating HMRC directly in this way is claimed to be secure, light-touch and far less burdensome than the tax returns of today. The sad reality is that this will impose significant extra admin and cost burdens on all but the smallest.

Businesses currently report information on tax returns and pay liabilities long after the end of the tax year. The government is changing the tax system so that it operates much more closely to 'real time'. Business will be able to see, through their digital accounts, a real-time view of their tax and a calculation of the tax due. By reporting information closer to real time, HMRC suggest businesses will find it easier to understand how much tax they owe, giving them far more certainty over their tax position and helping them to budget accordingly.

The government is consulting on options to simplify the payment of taxes, including whether to align payment dates and bring them closer to the point when profits arise, so that businesses make a single regular payment that covers all of the tax that they owe. This risks affecting cash flow if it ultimately means bringing forward the tax payment date.

## Who does it affect?

Some SMEs will already be using an online accounting system but the majority will not and they will need to start making the transition over the next 12-18 months. See page 6 on how we can help you with this.

HMRC has confirmed charities will not be affected by MTD but their trading subsidiaries will.

**Making Tax Digital: How does it affect landlords?**

HMRC are considering introducing an optional cash based accounting scheme for landlords to give them the choice of using the simplified accounting method.

### What is changing?

Currently property businesses are required to follow the accountancy rules set out by Generally Accepted Accounting Practice (GAAP) that recognise income earned and expenses incurred in the period, whether or not the amounts have actually been received or paid.

This can be a problem for landlords as many tenants often pay rent in arrears, therefore the plan is to give landlords the option to use cash based accounting.

This method of calculating tax works on a cash in cash out basis. This means tax is only accounted for on income when it is received and expenditure when it has been paid.

### Who does it affect?

Over 2.5 million property businesses, both individuals and partnerships of individuals with unincorporated property businesses, as well as their agents and representative bodies.

It is designed with the simplest property businesses in mind – those with small numbers of properties or another main source of income.

According to the consultation documentation, landlords with low rental income (originally below £10,000 but now to be confirmed) will not be mandated to keep their business records digitally or provide quarterly updates to HMRC.

**Making Tax Digital: How will it affect sole traders?**

## What is changing and why?

*1 – Proposal to increase the turnover limit for the cash accounting basis*

Cash based accounting is a simple method of calculating taxable profits for trading businesses with straight forward tax affairs. With cash based accounting, businesses only need to keep records of their income and expenditure, with profit before tax being calculated as income received less expenditure paid.

Currently, businesses can choose cash based accounting if their turnover is below the VAT threshold of £83,000. However due to the method's popularity there has been demand for the turnover threshold to increase. This is subject to further consultation but perhaps up to £150,000.

*2 – Reforms to basis periods for the self-employed*

The policy aim is to simplify the rules around basis periods and give people flexibility to change their accounting dates to suit their businesses giving a better understanding of their tax position and cash flow at all times.

Currently businesses are required to prepare accounts on an annual basis. Making Tax Digital will require people to report more regularly, at least quarterly.

Sole traders may choose accounting dates that fit in with other reporting obligations and individual preferences.

Shorter tax accounting periods may suit those with simple business affairs or those who want accounts to fit in with seasonal or fixed term sources of income.

*3 – Reforming the capital/revenue divide within the cash basis*

This will simplify rules for reporting capital and revenue expenditure and reduce complexity.

The plan is to remove the need to distinguish between capital and revenue expenditure for businesses using cash based accounting, making it easier to categorise expenditure.

## Who does it affect?

Self-employed individuals and partnerships, their agents and representative bodies.

**Making Tax Digital: How does it affect partnerships?**

Making Tax Digital proposes abolition of the annual tax return for partners and LLPs and the ‘simplification’ of reporting requirements for partnerships is proposed too.

### What is changing?

There are plans to abolish the current requirement on partners to report their individual profit share in an annual tax return and instead, through a nominated partner, partnerships will fulfil the obligations of Making Tax Digital, maintaining digital records and providing regular updates on behalf of all the partners. Each partner’s estimated income would be based on the profit allocation as reported to HMRC. As a result, each partner will not need software to maintain their own digital records or need to regularly update HMRC unless they have other business interests.

### Who will be affected?

HMRC expects around 400,000 ‘ordinary’ partnerships will be affected.

Limited liability partnerships (LLPs) and partnerships which have partners that are not individuals are not included in the plans to exempt unincorporated businesses with income below £10,000 as the proposal currently stands.

The largest partnership with turnover in excess of say £10m (to be confirmed) will be deferred from registering for MTD until 2020.

**Making Tax Digital – Likely reporting requirements**

HMRC does not want to see every sales invoice and every expense receipt. Whilst it does not want to see transactional data, it does want accounts summary information every quarter.

## Sole Traders

As a minimum, HMRC is looking for quarterly updates to reflect the same categories as currently required by a Self-Assessment return:

- Turnover
- Other business income
- Cost of goods bought for resale or goods used
- Construction industry – payments to subcontractors
- Wages, salaries and other staff costs
- Car, van and travel expenses
- Rent, rates, power and insurance costs
- Repairs and renewals of property and equipment
- Phone, fax, stationery and other office costs
- Advertising and business entertainment costs
- Interest on bank and other loans
- Bank, credit card and other financial charges
- Irrecoverable debts written off
- Accountancy, legal and other professional fees
- Depreciation and loss/profit on sale of assets
- Other business expenses

In reality, it may be best practice to expand some of the categories to help prevent nudges from HMRC.

## Landlords

As a minimum, HMRC is looking for quarterly updates to reflect the same categories as currently required by a UK property page contained within a Self-Assessment return:

- Income
- Rent paid, repairs, insurance and costs of services provided
- Loan interest and other financial costs
- Legal, management and other professional fees
- Other allowable property expenses

A large number of landlords use letting agents to manage properties on their behalf. Letting agents typically collect the rents due and often pay for occasional repairs to a property, on behalf of the landlord, deducting the repair expenditure and their fees from the gross rents collected. The letting agent may then provide the landlord with an annual statement of gross rents collected, less any expenditure. The landlord will then usually take the statement, along with his mortgage interest certificate, to his accountant to prepare his rental accounts.

Quarterly reporting is going to change that type of arrangement. The landlord is going to need quarterly statements at the very least and will need to upload any expenditure receipts.

## How to keep digital records

MTD will be a massive change and challenge for all taxpayers, but especially so for those who have always kept their records manually (or on computer spreadsheets), and give their records to their accountant once a year. After April 2018, everyone will be required to use accounting software of some sort, and keep records in real time. Cloud-based accounting systems such as QuickBooks Online offer this capability with the added advantage of allowing the accountant to 'log in' to review how things are going throughout the year.

**Other advantages of moving to 'digital' cloud accounting systems**

### Effective data sharing

With Cloud accounting, your financial information is instantly and automatically shared between everyone in your team who has the authority to access it. It can be updated in real-time with the minimum of data entry and easily accessed through any computer, tablet or handheld device. So your BWM accountant sees the same information as you, allowing us to proactively provide expert advice, and help you to make more informed business decisions.

### Reduced hardware costs

With most of the software processes and data storage handled by the 'back end', cloud computing systems place much smaller demands on the 'front end' devices that your staff use to do their jobs. This means that you can streamline your hardware: you don't need powerful processors or large volumes of data storage locally because all of that capacity is provided by large servers elsewhere in the world, and paid for by the service provider.

### Reduced software costs

In the past, if you wanted everyone in your workforce to have a particular piece of software installed on their computer, you would have to pay for licences for each and every one of them. With cloud based software such as Xero, Sage One or Quickbooks Online you subscribe with a single payment, or monthly subscription, and can access it through as many devices as you like.

### Increased reliability and security

Whenever you upload anything to the cloud, it's stored on a server and automatically backed up by at least one other copy stored on a different machine. Cloud computing systems have inbuilt redundancy which means they are never being used at full capacity so there is always that redundancy to allow for outages on any part of the network.

Of course it's important as always to take great care with log-ons and passwords security and follow best practice guidance in this respect. It's worth mentioning that having a reliable and speedy broadband service is key too!

### How can we help?

For a few years now we have been working with leading Cloud accountancy software providers and have been helping clients to review their systems for robustness and ability to cope and ultimately to move from desktop software to cloud based platforms. We can offer free demonstrations of cloud solutions, such as QuickBooks Online which is relatively inexpensive and user friendly, at our office or over the internet so please get in touch with Vicki Harper, Director of Client Services if you would like to know more.

## Next Steps

MTD is also a huge project for all businesses or landlords. MTD is coming, so do watch this space for further information and feel free to speak to us about the implications for you.

For more information on MTD please contact **John Elliott** **Sue Stephens** or your usual contact at BWMacfarlane.

**FOR GENERAL INFORMATION ONLY**

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

**About Us**

**Professional, Personal, Affordable.**

We are one of the leading, independent chartered accountancy practices in Liverpool. At BWMacfarlane we provide a wide range of accountancy and business support services to organisations and individuals throughout the North of England and beyond. Our experienced and skilled partners and their teams are ready to support you with high quality, individual yet affordable services however complex your personal or business needs.

For more details of how we can help you transform your business, please visit www.bwm.co.uk or call us on 0151 236 1494.