

**Consultation: Notices made under regulations 3, 8, 12 and 16 of the Income Tax (Digital Requirements)
Regulations 2021 (SI 2021) No. 1076)**

Response by the Chartered Institute of Taxation

1 Executive summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 We are concerned at the lack of detail in the draft notices regarding some of the key requirements of Making Tax Digital for Income Tax Self-Assessment (MTD for ITSA), such as the level of granularity at which transactions should be recorded, clarity over situations such as joint-property owners and the use of the cash or accruals basis, an explanation of the requirement for digital links, and how the End of Period Statement (EOPS) and Final Declaration (FD) process will operate. This can be contrasted with VAT Notice 700/22: Making Tax Digital for VAT, which provides a much more comprehensive explanation of the comparable requirements. It is not satisfactory to say these aspects will be covered in guidance, of which there is currently no sign, when taxpayers are being encouraged to join the pilot.
- 1.3 More generally, we remain concerned that the limited testing and software availability and uncertainty over critical elements of taxpayers' obligations will prevent a successful launch of MTD for ITSA in April 2024. As further detail of the requirements is confirmed, the likely costs of compliance should be also reviewed. We think it is appropriate to objectively review the implementation timetable, and reassess what is reasonably deliverable and by when.

2 About us

- 2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it –

taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

- 2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.
- 2.5 Our stated objectives for the tax system include:
 - A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
 - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
 - Greater certainty, so businesses and individuals can plan ahead with confidence.
 - A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
 - Responsive and competent tax administration, with a minimum of bureaucracy.

3 General comments

- 3.1 Four draft notices were published on 1 July 2022, all in accordance with the Income Tax (Digital Requirements) Regulations 2021 (SI 2021/1076). They are: a 'software notice' (further to regulation 3), an 'update notice' (regulation 8), an 'end of period notice' (regulation 12) and a 'retail sales notice' (regulation 16).
- 3.2 We are concerned that the draft notices fail to address some of the key requirements of MTD for ITSA, such as the level of granularity at which transactions should be recorded, how to deal with situations such as joint-property owners and the use of the cash or accruals basis, an explanation of the requirement for digital links, and how the End of Period Statement (EOPS) and Final Declaration (FD) process will operate. The draft notices are a poor relation to VAT Notice 700/22: Making Tax Digital for VAT, which provides a much more comprehensive explanation of a business's obligations.
- 3.3 It is vital that the draft notices are expanded to include similar levels of detail. The suggestion that guidance will be published 'later in the year' is simply too late if taxpayers are being encouraged to join the pilot now. A firm commitment is needed in relation to what guidance will be published and when, as well as publication of the notices themselves

- 3.4 Indeed, the lack of substance to the notices appears to reflect the fact that critical elements of taxpayers' obligations are still to be decided. It also appears symptomatic of the fact that significant complexities either need to be overcome, or will be imposed on those within scope. In our response to the original (albeit stage two) consultations in 2016¹, we said that real simplification of the tax system should take place before introducing mandatory digital record keeping and reporting. Many of the difficulties now being faced are because no such simplification has taken place.
- 3.5 While April 2024 is 20 months away, testing is currently at such a small scale that it seems impossible to undertake a full cycle of testing (including EOPS and the Final Declaration) with sufficient taxpayer and software types before c.4million businesses and landlords need to simultaneously start complying (especially considering the low awareness of MTD for ITSA²).
- 3.6 As new information comes to light, we are becoming increasingly concerned that the costs of compliance may further increase. For example, it now appears it will be necessary to reconcile the non-cumulative figures in the quarterly updates with the annualised figures in the End of Period Statement, yet HMRC's estimates do not attribute any cost to what could be an arduous process. The cost versus benefits of MTD should be kept under constant review as we learn more.
- 3.7 In the light of all the above, we think it is time to objectively review the implementation timetable, and reassess what is reasonably deliverable and by when, giving consideration to a staged roll-out or a longer period of testing.
- 3.8 Notwithstanding the above, we comment on each of the draft notices below.

4 The software notice

- 4.1 This notice states:

“Functional compatible software must comply with the following condition: once a digital record has been entered into a software program that forms part of the functional compatible software, any transfer, recapture, or modification of that digital record within the functional compatible software must happen digitally and not manually”

- 4.2 We would suggest that the notice clarifies the definition of 'digital records', particularly in the context of spreadsheets and bridging software. Many small businesses will continue to use spreadsheets as a means of recording data and confusion remains about whether and how this can continue whilst meeting the digital records criteria.
- 4.3 We are concerned with the term 'modification', which suggests that if any corrections need to be made to an entry, then they must happen digitally rather than manually.

¹ https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/471493c4-8ed6-4e37-84d8-c3a436492935/161107_MTD_bringing_business_.pdf

² https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fassets.publishing.service.gov.uk%2Fgovernment%2Fuploads%2Fsystem%2Fuploads%2Fattachment_data%2Ffile%2F1078217%2FFINAL_for_submission_MTD_for_ITSA_ODT.docx&wdOrigin=BROWSELINK

- 4.4 We do not see how this can happen in practice. If, for example, an entry has been recorded as wages, when it is in fact drawings (not uncommon for a sole trader), that will need to be manually corrected (modified) by the business or their agent. We do not see how the software itself can do that digitally. Indeed, to state that modifications must be 'made digitally' essentially means that disallowances and corrections cannot be made at all.
- 4.5 This is where the explanation and context provided in the VAT notice is important, making clear the need to use digital links, rather than actions happening digitally. While the VAT notice does also use the word 'modification', it is clear that is in the sense of the data's 'journey' from point of entry through to submission of the VAT return. Illustrative examples should also be included in the ITSA notice.
- 4.6 Like the VAT notice, the ITSA should also explain the level of granularity at which each transaction should be recorded ie what the 'digital record' actually is. For VAT registered businesses we would recommend consistency with the VAT rules, but there may be an opportunity for simplifications over and above three-line accounts for those who are not VAT registered.

5 The update notice

- 5.1 This notice lists those income expenditure transactions which should be recorded. The notice is divided into sections: trading income, property income (sub-divided into: UK property, overseas property, UK FHL property and non-UK FHL). We have several comments on the notice:
- 5.2 Furnished holiday lettings (FHLs) have been isolated under their own heading of property income, whereas, during recent discussions with HMRC, we understood that FHLs and non-FHLs were grouped together according to whether they were UK/EEA based or not, and each subject to one set of quarterly updates and one EOPS. This notice requires four categories of property income, and so we would appreciate confirmation of which is correct.
- 5.3 The notice should also explain that separate sets of digital records must be kept for each trading business. As drafted, the notice implies that there is just one set of records and quarterly obligations.
- 5.4 Some of the expense transactions specified will not be known or have been calculated prior to the quarterly reporting obligation, such as depreciation and profit/loss from asset sales. We do not understand that these need to be calculated each quarter and this heading should be explained in the notice.
- 5.5 Similarly, for non-FHLs, mortgage interest relief restrictions may be in place, in which case, would the full interest figure be entered into the 'Residential property finance costs' section? Or would they be left blank and the basic rate reducer be entered within the EOPS – in which case where on the EOPS as there appears to be no heading for it? This should be explained in the notice.
- 5.6 While the EOPS notice states that disallowable expenditure should be removed at that stage, we think it worth confirming in the update notice that expenses which have an element of private use can be recorded in full, provided that any necessary adjustment is made in the EOPS. The notice may also usefully cross-refer to the notes to SA103F which provide useful guidance about these different categories of income and expenditure.
- 5.7 If a type of income or expense does not exist, should a '0' be entered or should it be left blank? Also, there seems to be no option for any explanation of the figures within the quarterly reports eg a form of 'white

space'. Our original understanding is that these figures would not be subject to any scrutiny prior to the submission of the EOPS (within which additional information can be included and corrections made). However, if taxpayers are expected to submit correct (not merely complete) figures, then the opportunity to settle any potential misunderstandings early on, through a white space explanation, prior the EOPS might be welcome.

- 5.8 There is also no indication of whether these figures should be declared on a cash or accruals basis. For those with turnover under £150,000, the default position for a property business will be operating on the cash basis, but there appears to be no option to indicate a preference for the accruals basis. Likewise, for trading businesses, there is no indication or clarification in this notice about how a trader will notify HMRC of the basis on which the figures are produced should they opt for the cash basis following the year end; similarly, there is no means of notifying a move away from the cash basis until the EOPS is completed. Further, it should be explained how businesses which use different bases of accounting for VAT and income tax (eg cash accounting for VAT, accruals accounting for income tax) should record their transactions.
- 5.9 We remain concerned at the lack of awareness amongst landlords, many of whom will not regard themselves as being in business at all, especially those 'accidental landlords' who have a single property let out merely because they are unable to sell it. By addressing this notice to 'businesses with property income' there is a good chance this will bypass many taxpayers who are unaware of their obligations. We would encourage use of terms like 'UK/non-UK property owners with rental income', to help get the message across to landlords of their MTD obligations.
- 5.10 We note that those trading and property businesses with turnover under the VAT threshold are able to submit three-line accounts. While this will be a simplification for those businesses, we query whether this is consistent with the objective of reducing errors and omissions (with the use of nudges and prompts in many cases), especially as we understand that businesses with a turnover below the VAT threshold account for around 80% of the 'error' and 'failure to take reasonable care' elements of the tax gap.
- 5.11 In any event, the notice should explain over what period of time the turnover is examined. Is it the tax year as per MTD quarterly reporting, or is it as per the own business's VAT annual cycle? A cross-reference to the notes to the SA103S might also be useful.

6 End of period notice

- 6.1 This notice sets out the requirement to provide totals of the amounts set out in the update notice, along with additional information to be entered under the various trading/property headings.
- 6.2 The first requirement is to provide "the totals of the amounts falling within the applicable categories of transactions detailed the Update Notice". It is not clear how any necessary corrections to the quarterly updates should be dealt with, and how the disallowance or expenditure should be undertaken (eg as a single adjustment, or a correction of each individual entry). The notice should better explain how to translate the quarterly figures into an annual one for the EOPS.
- 6.3 In relation to the additional information, notable absences from these lists include: pension charges (on exceeding annual/lifetime allowances), gift aid claw-backs, tax reducers (e.g. EIS relief and mortgage interest deductions / restrictions) and the Higher Income Child Benefit Charge. Do these need to be made through

the EOPS process, or the Final Declaration? Even if not part of the EOPS, the notice should confirm this and explain how these adjustments should be made.

- 6.4 There is no explanation how businesses whose year-end is not 31 March – 5 April should undertake their EOPS (or indeed their final declaration). While in practice software might undertake those calculations, the notice should set out what is required.

7 Retail sales notice

- 7.1 We think the opening sentence is potentially confusing. It says that “digital records means a single digital record of the daily gross takings for any retail sales made”. But ‘digital records’ doesn't mean a single digital record; it comprises the entirety of the business’s records. However, what retailers can do is keep a digital record of your daily gross takings (DGT) rather than a separate record of the individual supplies that make up the DGT. Perhaps the wording in paragraph 3.5 of Notice 700/22 would be better?
- 7.2 Further, the list of inclusions and exclusions seems to replicate what is set out in the Retail Scheme Notice 727/5 (see section 5). It may be better to simply cross-refer to that notice, to avoid potential confusion or differences emerging over time.
- 7.3 It would be useful if the notice could clarify how a ‘retailer’ is defined. Whilst businesses involved in purely retail sales clearly fall within the scheme, there are many others for whom retail sales make up only part of their overall trade, or who would not consider themselves a retailer (eg a hairdresser or other service provider). Also, what about businesses where retail is only part of their overall activity. Similar issues arose when MTD for VAT was introduced, and whilst those relevant businesses are now familiar with these rules, those not registered for VAT will be encountering this for the first time and will need further guidance.

8 Acknowledgement of submission

- 8.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

27 July 2022