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Making Tax Digital for Income Tax and penalty reform: draft legislation

Draft Income Tax (Digital Obligations) Regulations 2026

Comments by the Chartered Institute of Taxation

1. Introduction

1.1. The Chartered Institute of Taxation (CIOT) is pleased to have the opportunity to comment on the draft Making Tax Digital and penalty reform legislation and the draft Income Tax (Digital Obligations) Regulations 2026.

1.2. 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 20,000 members, and extensive volunteer network, in providing our response.

1.3. Our stated objective for the tax systems 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.

Draft Legislation: Making Tax Digital and penalty reform

2. Clause 1 – Definition of 'relevant activity'

2.1. Previously, Schedule A1 to the Taxes Management Act 1970 (TMA) as enacted in Finance (No.2) Act 2017 defined 'business' essentially as those who engaged in 'activities' which were in scope of Income Tax under Part 2 and Part 3 of ITTOIA 2005. The draft legislation now provides the below noted definition of 'relevant activity' (with our emphasis):

'A 'relevant activity', in relation to a person, means any activity which may give rise to profits or other income for which the person would be liable to income tax chargeable under Part 2 or Part 3 of ITTOIA 2005 **if the person were UK resident**.'

In addition, the new legislation also defines a 'relevant person' as follows:

'A person is a 'relevant person' if the person is carrying on or has carried on a relevant activity.'

2.2. Our understanding is the objective here was to essentially create a 'deeming provision' to ensure that all those intended to be within the scope of Making Tax Digital for Income Tax (MTD) are indeed caught by the legislation. However, the definitions of have been drafted widely and we have a particular concern that the inclusion of 'if the person were UK resident' could bring non-resident sole traders and landlords within the scope of MTD digital reporting requirements, whilst not having a UK tax liability.

2.3. For example, take the example of a UK landlord who has overseas property income in excess of £50,000 in 2024/25 and becomes non-resident from 2025/26 onwards with no other changes in their tax affairs. The 'business' hasn't ceased because the relevant activities are ongoing and would be taxable if the taxpayer were UK resident. A strict reading may mean that such a taxpayer would be within the scope of MTD despite not being within the charge to UK tax and will continue to be within scope until that business ceases or their qualifying income drops below the threshold (for the required three-year period), as their business would have been a relevant activity **if they were UK resident.** If the individual continues to have UK-source income within the scope of MTD (a UK rental property, for instance), their digital obligations in respect of their overseas business/businesses could remain *ad infinitum*. This cannot be an appropriate outcome.

2.4. The explanatory note accompanying the draft legislation does not provide any detailed context for the changes. If the intention was to bring non-resident taxpayers within the scope of MTD (despite not having a UK tax liability) we would welcome further discussion with HMRC around the inclusion of such taxpayers, particularly given the cost of compliance when no UK tax liability. We discuss this issue in relation to the digital termination date in the Income Tax (Digital Obligations) Regulations 2026, '2026 Regulations', in point ten below.

3. Clause 2 – Exemptions from digital reporting requirements

3.1. We welcome the changes which allow digital requirements to be treated as never having applied where an individual is granted an exemption.

4. Clause 5 – Power to cancel penalty points and late submission penalties etc.

4.1. We understand from discussions with HMRC that the primary scenario where these powers may be used is in respect of insolvency cases, with a penalty reset being possible to provide insolvent customers with a fresh start following an insolvency, irrespective of how long it takes HMRC to be made aware that an insolvency process has been entered into. We also understand that the powers may also be used where statutory discretion is used to not award a point, or not to assess a penalty for one taxpayer and there are further taxpayers with identical circumstances where a penalty reset would maintain fair treatment. We would firstly note that this is not clear from the supplementary information published alongside the draft 2026 Regulations. We appreciate HMRC are aware of this, but we must recognise in writing in this submission that, as with any discretionary powers, appropriate guidance and safeguards are needed.

Draft Income Tax (Digital Obligations) Regulations 2026

Part 2 – Functional compatible software

5. The revised drafting of the definition of 'functional compatible software' in Regulation 3 seems to be seeking to clarify the obligations around digital links. We welcome this as in our view the previous regulations were unclear and implied that any amendment (including disallowing amounts as required by tax law) had to be made digitally, which would not have been workable in practice. However, we would suggest that the clarity of the legislation could be improved further. The definition of 'program' in Regulation 3(2) states that:

'…once data forming part of digital records has been recorded in one program, the amendment of or access to that data, using any of the programs, **does not require any further recording of data by the user**' [our emphasis].

It is likely that amendments to the data (either corrections or amendments to make tax or accounting adjustments) will necessitate further recording of data (for example, the amount of a disallowable portion of a particular expense). We would suggest that the wording be amended to '…does not require any further recording of **that** data by the user' so that it is clear that the original data needs to flow through from its initial entry point, whilst allowing for necessary adjustments later in the process.

6. Even with this change, the definition assumes that any correction to the records (for example, because an amount was entered incorrectly) will be by means of a corrective journal (ie a separate entry in the digital record) rather than by overwriting the original record. If this is the intention then HMRC will need to provide clear guidance for businesses.

7. One practical question which has been outstanding for a while is whether there is a requirement to maintain digital links between data once a tax return has been submitted. Our reading of the draft regulations is that there is no requirement to maintain digital links for this historic data whilst that data is just being held to satisfy the record-keeping requirements in s12B TMA. Should there be a need to amend the data or to resubmit any information to HMRC then there may be a need to ensure that appropriate digital links are in place. Is this assumption correct? We would ask HMRC to ensure that guidance covers this situation so that taxpayers are clear on their obligations and do not incur unnecessary costs (for example, maintaining licences to software that they no longer use to preserve digital links).

Part 3 – Period for which digital obligations apply

8. As drafted, Regulation 5 operates inconsistently. Regulation 5(2) states that where a business commences on or after 6 April 2025, its digital start date is consequential on the relevant individual submitting a Self Assessment return which includes that business. This ensures that a business is only given a digital start date when a) it is in the scope of UK tax and b) a latency period has elapsed, giving the individual time to prepare for digital record-keeping and reporting. This agrees with our understanding of how MTD is intended to work in practice.

9. Regulation 5(1), however, does not include a requirement that the relevant business must have been included in a previous Self Assessment return. In the majority of cases, Part 7, Chapter 2 of the Regulations will operate to take businesses out of digital requirements where the individual's income is either:

- within the charge to UK tax but below the relevant turnover threshold for the reference period; or
- not within the charge to UK tax at all.

As drafted, however, there are situations where the digital start date for a business will be the same as the time at which it comes into the UK tax net. For example, assume that an individual is resident overseas and has had both a UK and overseas property portfolio for several years. Whilst they remain resident outside the UK their UK portfolio will be within the charge to UK tax, but their overseas properties will not. If rental income from the UK portfolio exceeds £50,000 in 2024/25, the digital start date for that business will be 6/4/26 and the individual will be required to keep digital records and make quarterly submissions from that date. If they were to become UK resident on 6/4/26, Reg 5(1) would deem the digital start date for the overseas property business to be 6/4/26. The income-based exemption will not override this, as the individual's qualifying income for 2024/25 (their UK rental income) was over the relevant threshold. If the individual instead became UK resident on 6/4/27, the digital start date for their overseas property business would still seem to be 6/4/26 (ie the regulations seem to impose a reporting obligation even before the overseas business is within the charge to UK tax at all).

10. Please see the discussion in point 2.4 above. The current definition of a digital termination date in Regulation 6 of the 2026 Regs does not effectively address situations where a taxpayer with an overseas trade or property business ceases to be UK resident. We would suggest that Regulation 6 be amended to incorporate a deemed cessation of overseas trades and property businesses at the date at which an individual becomes non-resident. In our view that would ensure that digital obligations are effectively linked to the overarching scope of the UK tax regime.

Part 6 – Amendment and Correction

11. As currently drafted an individual who discovers an error in a previous quarterly update is required (under Regulation 17(4)) to correct that error 'at the same time as the next quarterly update which the person is required to give HMRC' (assuming that the business is continuing). There may be situations where the tax return for the year in question is due before the next quarterly update is submitted. Unless the figures are corrected before the return is filed then the return itself will be inaccurate – should this requirement be incorporated into the legislation?

Part 7 – Exemptions

12. We welcome the fact that, under Regulation 18, an exclusion can void a digital obligation that has already arisen. This will make it easier to advise clients in many circumstances and avoid situations where there is a theoretical obligation to keep digital records or make quarterly submissions which an individual is unable to meet in practice.

13. Currently the exemption for taxpayers who do not have a National Insurance Number (NINO), as provided at Regulation 22 of The Income Tax (Digital Requirements) (Amendments) Regulations 2024, was quite straightforward – if no NINO exists **at** 31 January before the tax year begins, the exemption applies. The draft 2026 Regulations have now seemingly changed this, with the NINO exemption now part of a broader set of regulations in Part 7. This makes the application of the NINO exemption much less clear, with no clear way to determine if the NINO exemption applies before 6 April (the start of the next tax year). For example, take a taxpayer who would otherwise be in scope of MTD from April 2026 but has no NINO. Should the taxpayer apply for an exemption despite the fact that they may be issued with a NINO by 6 April 2026? The taxpayer and agent cannot determine with 100% certainty in February that a NINO will not be issued before 6 April. HMRC could issue an exemption notice under Regulation 19(4), should they wait to see if HMRC issue such a notice?

14. We note that Regulation 19(2) in the 2026 Regulations provides that a taxpayer must specify on a notice the day on which they believe they became, or ceased to be, excluded. Regulation 20(2) of The Income Tax (Digital Requirements) Regulations 2021, 'the 2021 Regulations', also required the taxpayer to specify the reason why they thought they were digitally excluded. Will HMRC not require this information to determine whether the taxpayer is eligible for exclusion? And also, for ongoing monitoring of the validity of exclusions over time.

15. Regulation 19(3) reduces the period a taxpayer has to notify HMRC that they have ceased to be eligible for an exclusion to 30 days, reduced from three months, under Regulation 20(5) of the 2021 Regulations. The 2026 Regulations also do not provide a deadline within which HMRC need to respond to exclusion applications, removing the 28 day deadline which was in the 2021 Regulations. The legislative timescales have, therefore, been shortened for taxpayers, but extended indefinitely for HMRC. We would ask HMRC to clarify why they deem it appropriate to reduce the period to notify that exclusion has ceased from three months to 30 days? Furthermore, we are of the view that there should be a target response period for exemption applications, and notifications of cessation of exemptions by HMRC to the taxpayer. If this is not provided for in the legislation, it most certainly should be provided for within guidance. A clear timeframe is essential to help a taxpayer have clarity over their tax reporting obligations, and also, in line with HMRC's strategic objectives to improve day to day performance and customer experience.

16. Regulation 19(6) currently reads as follows: 'If, after the Commissioners have given a relevant person an exclusion notice without specifying a day under paragraph (3)(b)…'. Should this refer to paragraph (5)(b) rather than (3)(b)?

17. It is not yet possible to give notice under Regulation 19. We urge HMRC to open the application process as soon as possible. We also urge HMRC to provide more detailed guidance about the application of the criteria for digital exclusion in particular. This is vital for taxpayers and agents to understand who is and who is not likely to qualify for digital exclusions. We appreciate the scale of the roll out of MTD, and the smaller population of taxpayers who are eligible for exemption but the opening of the application process, and publication of guidance, is a vital step to effective implementation for this group of taxpayers.

18. Regulation 30(2)(a) exempts trustees (including executors and personal representatives) from the MTD requirements. As currently drafted that seems to be an absolute exemption (ie an individual is exempted in terms of their own income by virtue of being a trustee). We believe that the wording should be amended to make it clear that the exemption only applies to a trustee (or executor or personal representative) in their capacity as a trustee (etc).

19. Regulation 30(2)(b) introduces the exemption for donors of a lasting power of attorney under the Mental Capacity Act 2005 or enduring power of attorney, under Schedule 4 of the same Act. We would ask HMRC to please update to ensure the relevant legislation in Scotland and Northern Ireland are also included.

20. Acknowledgement of submission

20.1. 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. We would be pleased to discuss any of the above points further. Should you wish to discuss any aspect further, please contact technical@ciot.org.uk.

The Chartered Institute of Taxation
15 September 2025

About us

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.

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.

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.

Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.