Making Tax Digital for Income Tax: how will we fit it all in?

Management of taxes | Personal tax



23 May 2022

The roadmap for implementing Making Tax Digital for Income Tax Self Assessment leaves little margin for error. What could we do to focus on the essentials and allow more time to get things right?

I have been following the progress of Making Tax Digital (MTD) with considerable interest, and have recently been involved with the CIOT's development of a roadmap for MTD which is informing their discussions with HMRC.

I was slightly worried that, seven years after the end of the tax return was heralded, we don't seem to have a workable model for MTD for Income Tax Self Assessment (ITSA), so I decided to amuse myself by expanding the roadmap to chart the MTD pilots in more detail. The result is more than slightly worrying.

From pilot to mandatory implementation

The current pilot of MTD for ITSA is for a restricted set of taxpayers – those with 31 March or 5 April year ends and only a single source of income – so I have started there. The first full year end for these taxpayers ends on 31 March 2023, and they will file their last quarterly report by the end of April 2023. They then have to file an end of period statement, a fifth and final report to make all the necessary adjustments to the accounting figures, to finalise their taxable business or rental income by 31 January 2024.

MTD for ITSA is mandated for the majority of self-assessment taxpayers from April 2024. That gives two months from the first end of period statement due date for HMRC to learn the various lessons from the pilot and make appropriate adjustments; for software developers to integrate any technology changes in their systems; and for taxpayers and accountants to adopt the updated processes. That's a tight deadline. Even if the pilot generates some end of period statements from mid-2023, we only have six or eight months to get it right.

The pilot for more complicated taxpayers is due to start in April 2023. (More complicated, of course, means anyone who has more than one source of income, or a non-March accounting date – which is most of the target population for ITSA.) This means that the complex pilot starts before the last quarterly report of the simple pilot has been filed. At the point that MTD is mandated, the complex pilot taxpayers will have submitted only three of their four quarterly reports and no end of period statements. The partnership pilot has similar timelines.

Errors are inevitable, but mandation will happen before the end of the amendment window, even for those in the simple pilot. I am not aware that a pilot of the error correction process has even been announced. Taxpayers will therefore be committed to asserting that their figures are correct, with no guarantee of being able to make sure they are.

No margins for error

The point of a pilot is to identify problems with a process and allow them to be rectified, but the timescales available for these pilots simply do not allow for this. The greatest margin we have for resolving issues is the six to eight months available for the simple pilot – assuming that enough end of period statements are submitted early. The complex pilot has time to resolve issues identified with the first couple of quarterly reports, but later ones – and the whole end of period statement system –

will have to suck it and see.

There is also still considerable uncertainty over what an end of period statement consists of, even for the simple pilot.

I am concerned that we have two years before mandation in which to test a process which takes at least three years to complete. I would very much welcome a clear statement from HMRC setting out how it proposes to get a quart into a pint pot.

Possible approaches

Rather than landing this conundrum in HMRC's lap and walking away, I have done some thinking as to how it might be resolved. I can see a number of possible approaches:

1. Delay development of the end of period statement process: If no mandated statement is needed until January 2025, arguably we have a year to develop the process. This assumes that the quarterly report process can be finalised for mandation before the end of period statement process is known, which could create serious problems if it turns out to be wrong. (And if the two *can* be separated, the quarterly one seems heavily devalued.)

2. Delay mandation: Given that April 2024 is already nine years after the announcement, this seems unlikely to be acceptable politically.

3. Accelerate testing: Instead of real taxpayers submitting data in real time, set up a toy system allowing the whole process to be simulated in a matter of weeks. There are obvious limitations to this in terms of interaction with other systems.

4. Parallel running: Run MTD in parallel with the existing return process, so the consequences of errors in submission are minimised. This would cast some doubt on the value of the system.

5. Rethink the shape of MTD: This last is my favoured option. It seems to me that quarterly reporting has become an end in itself, and the original purpose of MTD has been lost.

Stepping back to 2015 and HMRC's document announcing the end of the tax return, the vision for MTD was that taxpayers would be able to:

- view and manage information online;
- deal with their tax affairs quickly and easily with simple, clear and personalised support;
- pay the tax they owe without having to resubmit information that HMRC already holds;
- link their business accounting software to their digital tax account;
- give authorised agents access to their digital tax account; and
- access a wider range of government services.

Some of this has been achieved – I can see my NIC record on my digital tax account, for example. A large part of this is still to be done, however. Linking accounting software to the digital tax account is only one such element, and it should not crowd out the other objectives.

Accounting software

In recent discussions concerning MTD for corporation tax, HMRC has indicated that the key point is to ensure that company accounts are digitised, rather than the tax returns. The same is true, in my opinion, for income tax: the main benefit of having quarterly returns made via accounting software is that it obliges businesses to use accounting software.

There is much debate about whether mandatory accounting software is a good thing for small businesses. In my view, the benefit is that it imposes a discipline on their tax reporting, much as the senior accounting officer rules impose discipline on large companies. It obliges taxpayers to be able to demonstrate that their tax returns are complete, and in a rather more concrete form than the requirement to keep records.

Accounting software is one way to provide that assurance but it is not the only way or necessarily the best way. I consider that this objective would be better achieved by broadening the requirement to have ‘accounting software submitting quarterly returns’ to an obligation to have ‘a demonstrably robust accounting process’. Adopting accounting software is an easy way to demonstrate robustness, but allowing alternatives which meet the same quality assurance criteria would remove many of the problems associated with MTD while still achieving the goal.

Note that quarterly returns are not essential in the way that an end of period statement is. End statements without quarterly returns can replace a tax return, but

quarterly returns without an end of period statements cannot.

The benefits of these proposals

The quarterly return process takes 12 months and is tied to 5 April. The key point is to remove this from the timeline. Instead, the current pilot could focus on the end of period statement, meaning that:

- the pilot could apply to years ended 5 April 2022, rather than starting then;
- the first end of period statement would be due by January 2023, giving a whole year more to test the system;
- businesses could join the simple pilot at any point;
- the complex pilot also gains a year, again with flexibility over joining date; and
- partnerships and error correction could be tested before mandation.

There would be more time for businesses, HMRC, software developers and agents to prepare for the pilots, more time to learn from them, and more flexibility over who could take part. It should also release resources to look at the other aspects of MTD.

A major issue with the pilots is that the end of period statement process is being left until last because it’s perceived as less urgent than quarterly reporting. However, as it actually feeds into the calculation of the tax liability it absolutely must work correctly, so it must be robustly tested.

The current roadmap allows for only simple end of period statements to be tested, in the few months before mandation, and by taxpayers who are signed up to the pilot now. The roadmap outlined above would allow a softer and more flexible entry to the pilot, with a smoother transition to more complex taxpayers, and more time to test and adjust the system. The solution is simple: don’t try to do it all at once.

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