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Making Tax Digital for Income Tax

(Published: Mar-25)

What is Making Tax Digital for Income Tax?

Making Tax Digital (MTD) is a UK government initiative aimed at modernising the tax system to make it easier for individuals and businesses to get their taxes right. In the first instance, MTD was rolled out for VAT registered businesses and individuals, and this has been fully operational now for a couple of years.

The next stage of MTD will cover Income Tax Self-Assessment (**MTD ITSA**) which will mean many property landlords and self-employed individuals will have to keep digital records for their businesses and rental properties.

The digital records maintained will form the basis of a submission to HMRC on a quarterly basis. Following the four quarterly submissions, an annual digital tax return will need to be filed which is like the current Self-Assessment tax return but there will be some differences. For example, some tax data on the final tax return will be automatically populated as HMRC's modernised system will allow them to gather data from external sources.

MTD ITSA will not change the dates when tax needs to be paid, nor will it change when the final tax return requires submitting.

Who will be affected?

MTD ITSA is being introduced for self-employed individuals and landlords with gross "qualifying income" of more than £20,000 where *qualifying income* is the <u>total gross income</u> from all sources of self-employment and property income before the deduction of any expenses. For sources of income which are jointly held, e.g. a rental property; it is only the individual's share of income that should be included.

When will you be affected?

MTD ITSA is being rolled out in three stages:

Stage one applies from 6 April 2026 and affects those with a gross qualifying income of more than £50,000.

Stage two applies from 6 April 2027 and affects those with a gross qualifying income of more than £30,000

Stage three applies from 6 April 2028 and affects those with a gross qualifying income of more than £20,000

How do you measure gross qualifying income?

For all stages of MTD ITSA, gross qualifying income will be measured using the most recent tax return filed prior to the mandation date assuming that all tax returns have been filed on time. So, for stage one, gross qualifying income will be assessed on income reported on the 2024/25 tax return which is required to be filed by 31 January 2026. For stage two, gross qualifying income will be assessed on income reported on the 2025/26 tax return which is required to be filed by 31 January 2027 and for stage three, gross qualifying income will be assessed on income reported on the 2026/27 tax return which is required to be filed by 31 January 2028.

Any income declared on those tax returns which do not cover a 12-month period will need to be adjusted proportionately. For example, if in the 2024/25 tax return, a tax player received £8,000 relating to 6 months' worth of income from a new rental property; when assessing whether they have breached the £50,000 qualifying income test, they would need to use an adjusted income figure of £16,000 in relation to that property.

What is not covered by MTD ITSA?

Partnerships which include Limited Liability Partnerships (LLP's) are not within the scope of MTD ITSA for now, nor are limited companies; however, it is intended that they will be one day! Whilst individuals in a partnership do not need to include their share of partnership income when considering the gross qualifying income test, they will need to include any self-employment or property income that they receive outside of their partnership, if they have any.

Self-employment or property income, which is not reported on a tax return, because it is covered by a relevant relief or allowance, for example rent-a-room relief or property/trading allowance, does not count towards the MTD ITSA thresholds.

How do you register for MTD ITSA?

It is the responsibility of each UK taxpayer to register for MTD ITSA if they breach the relevant threshold as described above. Tax agents will be able to sign their clients up to MTD ITSA, but this cannot be done yet.

When can you deregister from MTD ITSA?

The MTD income tax regulations will allow taxpayers to stop complying with the requirements where their relevant gross qualifying income falls below the threshold or when the business ceases permanently. To avoid the possibility of taxpayers joining, exiting, and re-joining on a frequent basis, as income fluctuates, the requirements will cease to apply only when the gross qualifying income falls below the threshold for three consecutive years.

For example, if you are required to comply with MTD ITSA for 2027/28 and your gross qualifying income falls below £30,000 in the tax years 2028/29, 2029/30 and 2030/31, then you will not have to comply with MTD ITSA from 6 April 2032 which is the start of the tax year following the finalisation date for 2030/31.

If you are affected, what do you need to do?

You will need to keep **digital records**, file **quarterly updates**, and complete an **end of year declaration**.

Below, we consider each responsibility in turn:

Digital record keeping

For individuals caught by MTD ITSA, individuals will need to keep a digital record of the amount, category and date of income and/or expense relating to their sole trade business and/or property business.

Digital records can be 'off the shelf' accounting software or HMRC will allow records to be maintained on spreadsheets.

Quarterly updates

HMRC will require all taxpayers caught by MTD ITSA to submit a quarterly summary of their income and expenses directly from their digital records. Fortunately, these are just summaries covering business receipts and payments; ***accounting adjustments***, e.g. adjustments for work in progress and/or closing stock etc., do not have to be included in the quarterly update. In addition, as the updates are cumulative, errors discovered should be corrected in the next quarterly update.

You should note that separate quarterly updates are required for each trade or property business, so for example, if an individual is both self-employed and owns rental properties then they will be required to make eight quarterly updates: 4 covering the self-employed trade and 4 covering the rental property business.

Unfortunately, because all taxpayers now have the same tax-accounting period (31 March or 5 April), all taxpayers will also adopt the same quarters for quarterly update purposes; and the deadline for submitting these quarterly updates is as shown in the table below.

Quarter End	Submission Deadline
31 March or 5 April	7 May
30 June or 5 July	7 August
30 September or 5 October	7 November
31 December or 5 January	7 February

Please note that the 'standard' quarter, as determined by HMRC is the 5th of each quarter but business <u>can elect</u> to change to the end of the 'calendar quarter'.

Yearend declaration

After the fourth quarterly update has been submitted, each taxpayer is required to file a "digital tax return". This will be like the current Self-Assessment Tax Return but as mentioned above, some items will be pre-populated, including details of income and expenses declared on the four quarterly updates. However, the yearend declaration will need to include the usual ***accounting adjustments***, for example, adjustments to include closing stock, work in progress, bad debts and tax-disallowable items, to name but a few.

The yearend declarations will be made directly from the individual's accounting software or HMRC online service which will be made available nearer the time. And again, like the current Income Tax regime, the deadline for the end of year declaration will be 31 January, following the end of the tax year.

So, what next?

From the above, it is clear to see that if you are caught by MTD ITSA, then change may be required and potentially those changes may be significant and therefore much more work may be required. In addition, it is estimated that about 780,000 individuals will be caught by MTD ITSA stage one and a further 970,000 by stage two; it is not yet certain how many will be affected by stage three as this was only announced in the Chancellor's Spring Statement.

Quite simply, our advice is to **act early** because with that many individuals looking for Accountants to guide them through the process, and register them with HMRC for example, it has got to make sense to act sooner rather than later. We believe there are two things that you must do:

> **Stay informed** – keep up to date with HMRC's guidance and any changes which HMRC may make, and
>
> **Talk to your Accountant** – speak with your advisor early. Consider if there are changes which you can make which mean you would not be caught by MTD ITSA and if you are caught, discuss how you can best work together to make the whole process as smooth and efficient as possible.

CONTACT US

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