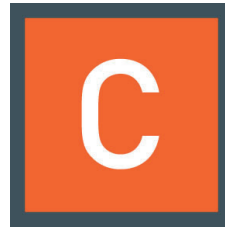


CARBON ACCOUNTANCY
CHARTERED ACCOUNTANTS



KEY GUIDE

Making tax digital

Introduction

DIGITISING TAX COMPLIANCE

The first set of individuals is now subject to the requirements of Making Tax Digital for Income Tax Self Assessment (MTD for ITSA), the latest stage in HMRC's project modernise the UK's tax administration system. The aim is to facilitate more digital reporting in 'real time', i.e. closer to the time of transactions.

The ultimate goal is for all regular transmissions of data between taxpayers and HMRC to be performed digitally, and where possible automatically. The initial target is for 90% of taxpayer interactions with HMRC to be digital.

MTD for Value Added Tax (VAT) has been compulsory for all VAT registered businesses (except those that are digitally excluded) since April 2022 and from earlier than that for most. MTD for ITSA is being staged according to level of income with two more groups of taxpayers joining in April 2027 and 2028. VAT registered individuals must submit separate MTD reports for income tax and VAT, but some MTD software may be able to combine reports due around the same time into one submission process.

Revised penalty regimes for late filing of MTD reports, and for late payment of tax under MTD, took effect from January 2023. Daily penalties may be charged where business records are not kept in a digital medium.

Contents



THE MTD TIMETABLE

The latest implementation schedule for the MTD programme



MTD FOR INCOME TAX

How MTD will affect groups such as unincorporated businesses and landlords who pay income tax



MTD FOR VAT

What MTD means for your VAT-registered business and how to file your return



COMPLYING WITH YOUR GENERAL TAX OBLIGATIONS

The importance of record-keeping to help make your tax reporting easier to complete



The Making Tax Digital timetable

Under the MTD rules nearly all businesses and landlords will eventually be required digitally to record tax-relevant data and to use MTD-compliant software to transfer the required information directly to HMRC's systems via an application programming interface (API).

Individuals who are not in business, and who do not let property, or whose income is £20,000 or less, will be encouraged (but not required) to use digital means to communicate with HMRC.

Planning point

MTD for income tax is being introduced gradually by reference to annual income reported in your tax returns. If you are likely to have to join MTD in April 2027 or 2028 it will be important to submit your tax returns by the 31 January filing date.

Sole-traders and landlords who have annual income from self-employment or property letting (or both) of over £50,000 have been required to register for MTD from 6 April 2026. They must keep digital business/property records and file quarterly updates, an annual end of period statement (EOPS) and an annual finalisation statement, all using MTD-compatible software. The remaining start dates are set out in the table.

Start date	Tax
6 April 2027	Sole-trader businesses and landlords who have annual income over £30,000 will be subject to the same requirements as those with income over £50,000.
6 April 2028	Sole trader businesses and landlords with annual income over £20,000.
No announced date	MTD ITSA will be extended to partnerships.

Who may be exempt from MTD?

An individual can claim exemption from complying with the MTD rules if he or she is 'digitally excluded'. This means it is not reasonably practical (for any reason) for that person to use electronic communications or digital tools to keep digital records.

To claim exemption from MTD for VAT, the business, or their agent, should contact the VAT helpline: 0300 2003700 or write to: BT VAT HMRC BX9 1WR. The business will have to provide details about how it currently files VAT returns, the reasons why it cannot file returns through MTD-compatible software or keep digital records, and any other reason why it cannot follow the MTD rules.

Individuals who are exempt from MTD for VAT will automatically be exempt from MTD for ITSA. Those businesses can continue to use alternative arrangements to submit VAT returns to HMRC and do not have to keep digital records. Also exempt from MTD for ITSA will be:

- People who have qualifying income of £20,000 or less;
- people exercising a Power of Attorney;
- non-UK resident foreign entertainers and sportspeople who have no other qualifying income for MTD;
- customers for whom HMRC cannot provide a digital service;
- trustees, executors or administrators of estates of deceased persons;
- non-resident companies that pay income tax.

Other people for whom it is not practical to use electronic communications or keep electronic records can similarly request exemption. You should apply for exemption before you are required to use MTD.

To apply for exemption from MTD for ITSA you should contact Self Assessment General Enquiries via the HMRC website, by other electronic means or by telephoning 0300 200 3310. People who will have to use MTD from 6 April 2027 can apply for exemption from summer 2026, and those who would be brought into MTD from 6 April 2028 will be able to apply from summer 2027. MTD aims to respond to an application within 28 days.

A few people will have a delayed joining date for MTD for ITSA (likely to be 2030 or later), namely:

- Lloyds Underwriters;
- ministers of religion;
- people who claim the married couple's allowance (where at least one partner was born before 6 April 1935) or blind person's allowance.

Temporary exemptions until April 2027

Some people are automatically exempt until April 2027 despite having income of over £50,000. They are people who had to complete the supplementary tax form SA109, which covers residency status and remittance basis income under the 'temporary repatriation facility' and think it likely they will do so again for the 2026/27 tax year. People who did not complete the form SA109 in 2024/25 but expect to be required to for 2026/27 will have to apply for exemption.

Also temporarily exempt until April 2027 are people whose 2024/25 tax return showed that they:

- claimed averaging relief;
- claimed qualifying care relief, eg a foster carer;
- received income from trusts or estates.

You will have to claim the exemption if your 2024/25 return did not show this but you expect your 2026/27 return to do so.

MTD FOR VAT

Businesses that become VAT registered are automatically included in the MTD regime upon registration, unless they are exempt or have applied for an exemption. They must keep their VAT records digitally and submit all VAT returns using MTD compatible software.

Where all the business owners are exempt from MTD for VAT the figures can be reported by telephoning HMRC, but a formal MTD exemption must be in place.

Software requirements and providers

HMRC does not provide software to submit VAT returns under MTD but publishes a list of 460 providers of MTD-compliant software which can submit VAT returns, (see <https://tinyurl.com/MTDsfwlist>). Some providers have free versions of their MTD VAT products available, which are mostly forms of bridging software. You can filter the list to suit your needs.

Where you use spreadsheets or accounting packages to compile your VAT data, you can use MTD-compatible bridging software to read that data from the spreadsheet or accounting



package and submit the required figures to HMRC via an approved API. The different software packages or spreadsheets must be connected with digital links.

It is important to check what you need the MTD-compatible software to do, how it will work with your current accounting system, and whether it will provide information about the VAT you owe or your VAT payment history.

EXAMPLE Digital links

Joan registered for VAT on 1 March 2026 and is required to use MTD to submit her returns.

Joan stores her VAT receipts manually, and uses spreadsheets to maintain her VAT records. MTD does not require businesses to store original documents electronically, so Joan can continue to store her purchase receipts manually, but must record the key information concerning each purchase electronically.

Joan digitally transfers the information necessary for the VAT return into MTD-compatible software. She has chosen to use bridging software that reads the necessary figures from her spreadsheet, but there are many other forms of digital links.

Joan must still preserve her VAT records for six years, but that information doesn't have to be kept in the same digital format it is recorded in. A download of data from cloud-based accounting software meets the MTD record keeping requirements.

Digital record-keeping requirements

The MTD rules require VAT registered businesses to record the following data points digitally for each transaction:

- the VAT on goods and services you supplied or received;
- the time of supply for everything you sold or bought;
- the value (excluding VAT) of everything you sold or bought;
- the rate of VAT you charged on goods and services;
- your reverse charge transactions, where you record the VAT on the sale price and the purchase price of the goods and services you buy.

The law allows businesses to record totals from a supplier statement instead of individual payments in the following cases:

- When a supplier issues a statement for a period, provided all supplies on the statement are to be included on the same VAT return and the total VAT charged at each rate is shown.
- Petty cash transactions for any purchases with a VAT-inclusive value under £50, and not totalling more than (VAT-inclusive) £500.
- Supplies made or received during a charity fundraising event run by volunteers, which are covered by one invoice.
- Purchases made on your behalf, supplied by a third party, detailed in a summary document. You are not required to record these purchases until you receive information on them from the agent.

If you use a VAT scheme (such as for retail businesses) there is some leeway for recording multiple purchases, as summarised below.



Retail schemes (used by shops, market stalls and takeaway food outlets)

Daily gross takings must be recorded. Individual sales do not need to be digitally recorded.

Flat rate scheme (for businesses with VAT taxable turnover not exceeding £150,000)

No need to digitally record purchases unless they are capital goods on which input tax can be claimed.

No need to digitally record the value of goods used to determine if you need to apply the limited cost business flat rate.

Margin schemes (for items such as: antiques, second-hand cars, or works of art)

No need to keep additional records in the digital system, or the calculation of the marginal rate, although those records must be maintained in some format.

HMRC also requires the following information to be recorded digitally and submitted with the VAT return figures:

- name of the business;
- address of principal place of business;
- VAT registration number; and
- any VAT accounting schemes used, such as the flat rate scheme.

Some documents must be preserved in their original form, such as import VAT certificates (C79 forms).

Digital links

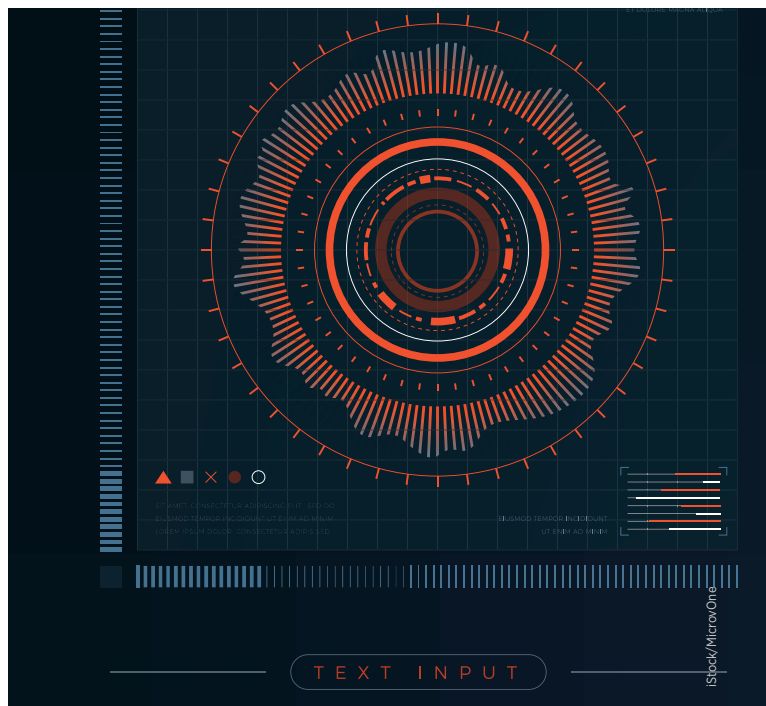
Under the MTD rules, the data necessary for the VAT return must flow from the accounting system to HMRC without human intervention to retype figures, or to copy and paste from one medium to another.

However, some calculations may have to be made outside the accounting software, such as partial exemption adjustments. It is permissible to enter data from the results of such calculations into the MTD-compatible accounting system – this action does not break the digital link.

Penalties

Any VAT return filed late will attract a late submission point. This applies even if there is no VAT to pay as reported on the VAT return.

When a business accrues a total number of points equal to the threshold relating to their VAT return frequency, HMRC will issue a £200 penalty. Any further late returns attract another £200 penalty.



Where the business completes a period of compliance during which all VAT returns are filed on time and all outstanding returns in the previous two years have been submitted, the total number of points is reduced to zero. Where the points threshold has not been reached the points levied will expire automatically after about 24 months.

Return frequency	Points threshold	Period of compliance
Annually	2	24 months
Quarterly	4	12 months
Monthly	5	6 months

The business' online VAT account will record the number of points and penalties levied.

All penalty points and monetary penalties can be appealed. Appeals are often on the basis that there was a 'reasonable excuse' for the lateness, namely a valid reason why the return could not be made on time.

Where VAT is paid late for periods beginning on and after 1 January 2023, up to two types of late payment penalties can be applied. The amounts charged depend on how long the payment has been overdue:



iStock/MicroStockHub

Period the payment is overdue	First penalty	Second penalty
up to 15 days	Nil	Nil
16 to 30 days	3% of VAT outstanding at day 15	Nil
31 days or more	3% of VAT outstanding at day 15 + 3% of VAT outstanding at day 30	10% per year on the outstanding balance, charged from day 31 until full debt is paid

Where the VAT is paid 31 or more days late, you will be charged the first penalty and a second late payment penalty.

The percentage rate for the VAT first penalty will increase to 4% from April 2027.

If a time to pay arrangement is agreed the penalty clock stops.

In addition, late payment interest is charged from the first day that the payment is overdue until the day it is paid in full. It is calculated at the Bank of England base rate plus 4%.

HMRC may impose penalties of between £5 and £15 per day if the business fails to record VAT data digitally and/or use digital links to transfer data between different pieces of software. In addition, HMRC may charge a penalty of £100 to £400 for each VAT return that is not submitted using

MTD-compatible software. The level of this penalty is determined by the annual turnover of the business.

EXAMPLE
Review of software

ABC Ltd's bookkeeper has used an accounting software package to maintain the company's accounting records. The company is required to submit VAT returns under MTD for VAT.

ABC Ltd's software provider has added MTD for VAT compatibility to its accounting software package. This allows ABC Ltd's bookkeeper to install the relevant updates to file VAT returns under MTD directly.

However, this is an opportunity for the company to review whether its accounting software best serves the current and future needs of the business and in particular whether it will encompass MTD for ITSA.

MTD FOR ITSA

The £50,000, £30,000 and £20,000 thresholds that determine when an individual must join MTD apply to the individual's qualifying income, namely total income from self-employment and property letting.

- Where a let property is jointly owned, each owner must include their share of the income in their qualifying income.
- Individuals who are resident and domiciled in the UK, or are deemed UK domiciled, must include income from foreign self-employment or property letting.

- Income of deemed domiciled individuals remitted from a year in which they were taxed on the remittance basis does not count towards qualifying income.
- If you are resident or domiciled outside the UK, only income from UK self-employment or property is included in qualifying income.
- Qualifying care receipts of carers are not included.
- Income from a partnership does not count towards qualifying income, unless it is disguised investment management fees or income-based carried interest.

The qualifying income for any tax year is taken from the tax return that was due for submission by the previous 31 January. For example, to assess qualifying income for 2027/28, HMRC will look at the tax return for 2025/26, due by 31 January 2027. If the 2025/26 tax return shows qualifying income of more than £530,000, you will have to use MTD from 6 April 2027. HMRC will tell taxpayers whose 2025/26 tax returns show qualifying income of more than £30,000, but the obligation to use MTD does not depend on receiving notification from HMRC.

Care is needed where a business has ceased trading. If your business ceases before 6 April 2027, that business does not have to join MTD but its income will still count towards your qualifying income, for example if you have property income as well. HMRC will identify a business that has ceased from the cessation box in the tax return, so it is important to complete it correctly.

Where a business ceases in 2026/27, you are likely to have to apply to HMRC for exemption. There can be other complexities associated with cessation of a particular source of income and you should seek advice.

Individuals whose business accounts run to 31 March can start their MTD obligations on 1 April instead of 6 April in the first year of operating MTD. This will avoid year-end adjustments.

If your accounting period is longer or shorter than 12 months you should annualise your income. For example if you become a sole trader but have only been trading for six months in 2025/26, you should double your income to find your qualifying income.

EXAMPLE

Turnover threshold for MTD for ITSA

Pete is a self-employed van driver. He lets a property for £6,000 per year and earns around £25,000 per year as a self-employed driver.

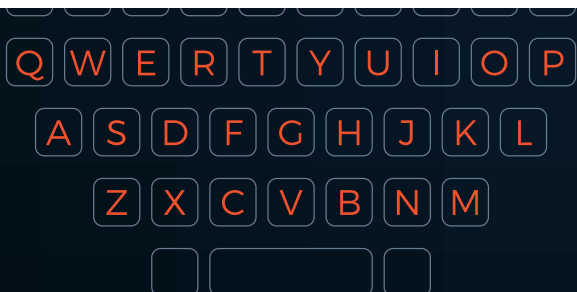
As Pete's total annual business and property income is £31,000 per year, he will be over the £30,000 turnover threshold for MTD for ITSA and will have to comply with the MTD ITSA rules from 6 April 2027.

When will MTD for ITSA reports have to be submitted?

Under MTD for ITSA, unincorporated businesses and landlords who are within the MTD regime have to report to HMRC totals of their income and expenses for each source of income incurred periodically, but at least quarterly. The quarters end on: 5 July, 5 October, 5 January and 5 April, although taxpayers will be able to elect to report for calendar quarters to 31 March, 30 June, 30 September and 31 December. The quarterly report must be submitted to HMRC by the 7th day of the month following the end of the quarter, i.e. by 7 August, 7 November, 7 February and 7 May whether or not calendar quarters are used.

HMRC will supply the taxpayer with an estimate of the amount of tax due based on the net income reported for each quarter, but the taxpayer will not have to do anything with this information.

After the end of the tax year, the taxpayer has to submit an End of Period Statement (EOPS), which will bring together the totals of income and expenses from each business and property

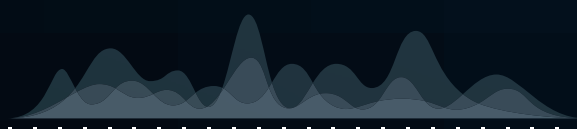


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GRAPH

income. It will also include any accounting adjustments, such as for capital allowances or disallowed expenses. The EOPS must be submitted by 31 January following the tax year end.

Taxpayers within MTD can no longer submit their tax return in HMRC's separate online filing system. Instead their EOPS must include all other income, such as dividends and interest, chargeable gains and claims for the year.

In summary, under MTD for ITSA, you generally have to submit up to four reports for each business you run each year, and separately for any property-letting income, plus an end of year statement. All of these reports need to be submitted to HMRC via MTD-compatible software.

What must be included in quarterly reporting

Each quarterly update must show the start and end dates of the period.

A self-employed person must also report:

- business turnover
- other business income
- cost of goods
- other business expenses under a series of specified headings.

A person with property income must report:

- total rent
- other property income
- lease premiums and reverse premiums

EXAMPLE

Timing of reports required under MTD for ITSA

Rob is a financial consultant who makes up his accounts to 5 April each year showing annual income of £80,000. Rob has had to start keeping digital records and file quarterly updates under MTD from 6 April 2026. He will submit his first quarterly updates, last self-assessment tax return, EOPS and finalisation statement on this timetable:

MTD Qrt/SA return	Income and expenses in period	Deadline for submission
Y1 Qrt1	6 April 2026 – 5 July 2026	7 August 2026
Y1 Qrt2	6 July 2026 – 5 October 2026	7 November 2026
Tax return: 2025/26 (not under MTD)	Year to 5 April 2026	31 January 2027
Y1 Qrt3	6 October 2026 – 5 January 2027	7 February 2027
Y1 Qrt4	6 January 2027 – 5 April 2027	7 May 2027
Y2 Qrt1	6 April 2027 – 5 July 2027	7 August 2027
Y2 Qrt2	6 July 2027 – 5 October 2027	7 November 2027
EOPS 2026/27	Year to 5 April 2027	31 January 2028
Finalisation statement 2026/27	Year to 5 April 2027	31 January 2028

- property expenses under a series of specified headings.

If your turnover from either self-employment or property letting is below the VAT registration threshold, you can use three-line accounting. This allows digital records to be tagged simply as income or expense. The one exception is where a landlord has finance costs such as mortgage interest, which must always be tagged separately.

Joint property owners

If you let property jointly you only record and report your own share of income and expenses. There are some ways in which you can simplify your recording and reporting:

- You can adopt three-line accounting;
- Instead of keeping full digital records, you can record a single total amount for property income received during a quarter, and for property expenses incurred during the tax year;
- Your quarterly reports then need only show a single figure for income with a single figure for your share of the expenses entered at the end of the tax year.

Preparing for MTD for ITSA

The first step in preparing your business for MTD reporting is to activate your Business Tax Account (BTA). Your BTA allows you to view all of the taxes your business pays to HMRC including PAYE and VAT.

The next step is to digitise your accounting system. You may choose to use accounting software or spreadsheets (with digital links to MTD-compliant software) for this task. A paper-based recording system will not be acceptable.

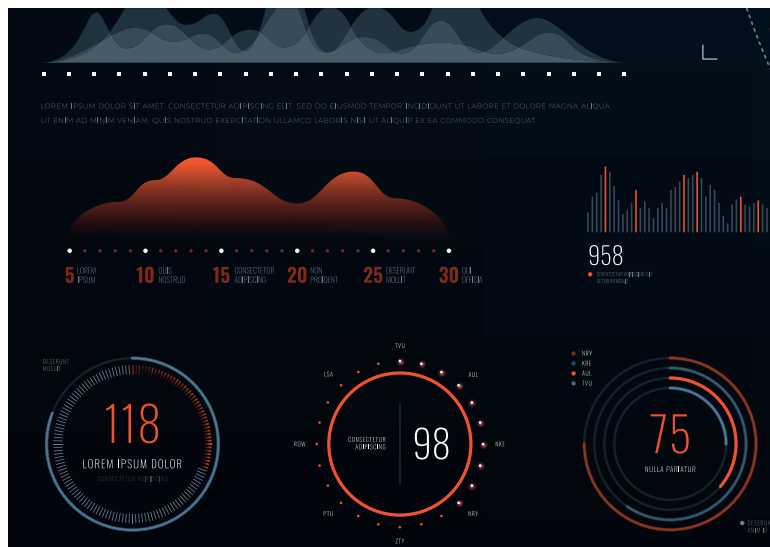
You can start to keep digital records at any point and HMRC recommends doing this ahead of your MTD start date to allow you to get used to it.

Planning point

In order to sign up for MTD you first need to have installed MTD compatible software. You also need to register for your online Business Tax Account (BTA) through the gov.uk website in order to receive information from HMRC under MTD. Your tax agent will not have access to your BTA.

MTD ITSA software

You will have to use commercial software that works with MTD ITSA from the date you are required to use MTD reporting. HMRC does not provide its own software but there is some free software for the smallest and uncomplicated businesses that will allow those taxpayers to file reports under MTD.



Most software providers now have suitable products, some of which are free, though not all have the same features. They come in two categories. If you currently use accounting spreadsheets, you can choose bridging software that connects to your spreadsheets to produce the quarterly statements and annual returns. Otherwise, there are many software products that create digital records by linking to your business bank account, scanning receipts and invoices, or by means of manual entry.

HMRC's guidance at www.gov.uk/guidance/find-software-that-works-with-making-tax-digital-for-income-tax includes a software finder tool designed to help taxpayers find software that suits their particular needs

Penalties

The penalties for late submission are points-based, like the equivalent VAT penalties. This means you will not face financial penalties for a single mistake but only if you persistently fail to meet your obligations. They will arise as follows:

- Each late annual return from 2026/27 will attract one penalty point. No penalty points will be imposed for a late quarterly submission during 2026/27.
- From 2027/28 each late quarterly submission and each late tax return will attract a penalty point until the penalty point threshold of four points is reached.
- A £200 penalty will be charged when the four-point threshold is reached.
- Another £200 penalty will be charged if you miss the deadline for any more submissions.
- If you have not reached the penalty point threshold, the individual penalty point will be removed automatically 24 months after it is incurred.
- If you have reached the penalty point threshold the points will be removed provided you meet two conditions:

- You make all your quarterly submissions and annual return on time for the next 12 months; and
- You have sent any outstanding quarterly submissions and tax returns for the previous 24 months.

Late payment penalties will be charged where any payment, other than a payment on account, is more than 15 days overdue as follows:

- No penalty where payment is up to 15 days late.
- If payment is 16 to 30 days late the penalty will be 3% of the tax owed at day 15. However no penalty is charged in the individual's first tax year under MTD.
- If payment is more than 30 days late, the penalty is 3% of the tax owed at day 15 plus 3% of the tax owed at day 30. In addition an annual rate of 10% is charged daily from day 31 on the outstanding balance until the tax is paid or for up to two years.
- From 2027/28 the penalty percentage will be 4% of the tax owed at days 15 and 30.

Late payment interest is also charged from the first day after the payment due date at a rate of 4% above Bank of England base rate. That makes the current interest rate 7.75%.

CORPORATION TAX

MTD will not be extended to companies. However, with very few exceptions, companies must use commercial software to file their corporation tax return and accounts to HMRC. HMRC's former online filing service closed on 31 March 2026. Companies also have to use software to file accounts to Companies House from 1 April 2027.

HMRC does not provide free software for submitting corporation tax returns and accounts.

Exempt companies will continue to be able to file on paper.

COMPLYING WITH YOUR GENERAL TAX OBLIGATIONS

Whether you have to file reports under MTD sooner rather than later, it is essential that you keep complete and accurate records of your business and other income so you can make accurate tax and VAT returns.

HMRC says that MTD will help businesses keep their records up to date, reduce errors made in recording expenses, and give the taxpayer a better idea of how the business is performing. However, digital record keeping on its own will not guarantee accuracy, and you must also ensure that all relevant income and outgoings are recorded.

In the long run the MTD data will allow HMRC to target businesses for tax enquiries that are reporting expenses in unexpected categories, or have unusual patterns of income.

In the short term HMRC will continue to use the following methods to ensure everyone pays the correct amount of tax due:

- Undertake random or targeted compliance checks on tax returns.
- Use third party data to check the information reported in tax returns.

Where HMRC finds that a person has not taken enough care to make accurate tax returns, penalties will usually be charged. Pleading ignorance of the rules does not avoid penalties. Material inaccuracies are likely to be spotted, so it is worth making the effort to get your tax right.



HOW WE CAN HELP

All businesses need to keep complete and correct accounting records to enhance business efficiency and to make accurate tax returns, whether or not they have to comply with the MTD rules.

We can review your accounting systems and advise on accounting software that will best serve your business needs.

If you need to comply with MTD for VAT or for ITSA, we can help you ensure your software is compatible and, where necessary, help you set up new accounting systems and become proficient at using them.

We can make the necessary reports on your behalf to HMRC, if you have authorised us to act for you, and provide direct access to your accounting data and software.

We can help you with IT security and keep you up to date on any changes in tax and accounting compliance that affect your business.



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