ACCOUNTANCY

Information Sheet

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We hope you enjoy reading this information sheet and find it useful. Please contact us if you would like to discuss any matters further.

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Making tax digital: What are the implications for landlords?

Making tax digital (MTD) represents a major change to how most people will manage their business' tax and financial affairs. It will not have touched very many property investment businesses yet, but this will change for more landlords broadly within the next couple of years.

The following is an overview of some key points.

Timetable: MTD for VAT

This is being extended 'downwards' to cover all VAT-registered businesses, rather than only to larger businesses making VATable supplies above the VAT registration threshold (as set into the original legislation). Nevertheless, from April 2022 MTD for VAT will apply to any VAT-registered business, no matter how small, including those registered voluntarily.

While standard residential property businesses will not be VAT-registered (such supplies are almost all exempt from VAT), some landlords will be VAT registered because of:

- Bed and breakfast businesses;
- Furnished holiday accommodation; *or*
- Commercial property letting (typically, but not always necessarily, a VATable supply, in many cases).

Some property businesses will have a mix of VATable and exempt supplies and will have voluntarily registered for VAT despite modest levels of VATable income, on the basis that the partial exemption regime was helpful. They may choose to de-register for VAT to avoid MTD until MTD for income tax becomes mandatory.

Many more property businesses will be affected by MTD for income tax. Not only will it apply to more businesses, but it will also impose further requirements on those businesses already caught by MTD for VAT. The April 2024 date does not apply to all businesses under income tax; general partnerships are not currently scheduled to start until April 2025, for example.

MTD generally: Why it matters

MTD sets into law that once a taxpayer is caught by MTD, they must:

1. record each single business transaction digitally - digital records and digital links;
2. update their digital business or accounting records at least quarterly; *and*
3. submit online returns to HMRC every three months for each business separately - on top of existing annual return obligations.

They will also likely choose to adopt an accounting suite that has been built to be MTD-compliant - essentially, 'HMRC-approved'. There are many business owners who think: 'I file VAT returns online every three months anyway, so I am basically MTD-compliant already'; but in a good number of cases, they will be wrong.

Digital records and digital links: Hidden risk

Fundamentally, the digital records requirement means that the taxpayer may input data manually only once. The software used must be sufficiently sophisticated that all parts are updated automatically from that point onwards - so-called 'digital links:

- One cannot re-key data.
- One cannot 'cut and paste' entries between different accounting programmes.
- If you want to transfer data to your agent so they can prepare financial statements, it must be done electronically, with digital links to their software.
- All returns will have to be submitted to HMRC electronically, without any manual 'handling' of the records.

Some businesses have set up their own electronic accounting systems, ranging from simple homemade spreadsheets to complex databases that have been custom-built for the business. In theory, it is possible to acquire 'bridging software' to digitally link spreadsheets together, and to make online submissions, etc. But this will add further time and cost, and will make it harder to update spreadsheets without breaking the digital links. Many businesses will decide to move to an accounting suite on the basis that the digital links and submission facilities will be built- in.

MTD for VAT and digital records and Links

HMRC has played canny with its MTD transition strategy. As VAT already works to a quarterly online submission routine (for most businesses), many businesses will have moved to MTD for VAT with little obvious difficulty. But whether a business has complied with the digital records and digital links requirement will be down to HMRC to test when it makes a VAT visit. HMRC initially applied a digital links 'soft landing period' up to April 2020 and then extended it to April 2021. HMRC's light-touch approach means that there will have been very few penalties (up until now) for failing to operate digital records and digital links; meanwhile, HMRC can claim that the transition to MTD for VAT has been 'a great success'.
So far, businesses within MTD for VAT have only had to ensure digital records and digital links for their VAT records and VAT return submissions. When MTD for income tax starts in earnest from April 2024, all the other parts of their financial systems will have to 'talk to each other' automatically as well.

MTD for income tax and digital recordkeeping

Most landlords are not VAT-registered, so they will not currently be making quarterly returns. Many landlords have a small number of properties and have not previously had to worry about pulling together their books and records until it is time to file their annual tax return, usually a good few months after the end of the tax year.
This will have to change, as the MTD legislation includes a requirement to update one's business records at least in time for the next quarterly MTD return. As MTD for income tax basically covers all business transactions, the scope of digital records and digital links is much wider than what is required for MTD for VAT.

Designatory data: More hidden risks

Each quarterly return must observe the 'designatory data' requirements. This basically covers a business' standing information - and if any of the dozens of data points change, you have to tell HMRC.
While things like the taxpayer's name and date of birth are unlikely to be problematic, note for landlords the following also comprise 'designatory data':

- Has the business adopted the cash basis?
- The number of properties currently rented out in the UK (or overseas).
- Is any property let jointly and, if so, what are the details of the joint landlords?
- Identify each property that is part of the property business.
- Date of cessation of the business.
- Are there any furnished holiday lettings?

Having to decide whether or not a business is operating the cash basis, or may have ceased, basically in real time, may be difficult. And it would also seem quite unreasonable. For example, the taxpayer is supposed to have until 31 January of the second year following the tax year to decide if they want to opt out of the cash basis; likewise, HMRC has previously given up to three years to decide if a rental business has ceased or is continuing. In some cases, it can be a technically complex issue (see HMRC's Property Income manual at PIM2510, for example).

Exceptions and easements

There are exemptions from having to operate MTD, the key ones being:

• Where total annual gross income across all businesses does not exceed £10,000 (for MTD for income tax).
• Where there are grounds by reason of age, religion, accessibility (internet, broadband, computers, etc.), or similar.
• Trusts are now exempt from MTD for income tax.
• Retail trades may summarise records, rather than having to record (say) the sale of each tin of beans separately.

Conclusion

MTD will force a profound and wide-ranging change to the way that most landlords keep their financial records. I have touched upon some of the risks, but there are others - such as amending the quarterly returns after submission, which will be flagged separately to HMRC.

Fundamentally, business owners will have to spend more time (and in most cases spend more money) to comply.