Low Incomes Tax Reform Group

A voice for the unrepresented

Making Tax Digital for Corporation Tax consultation
Response from the Low Incomes Tax Reform Group (LITRG)

1. Executive Summary

1.1. We are pleased to be able to comment on the proposals for Making Tax Digital for Corporation Tax (MTD for CT) from the perspective small companies with modest profits. In this context the small company will often be a sole director/shareholder company or a family company with a small number of family members as shareholders and/or directors. The issues for these companies are of course very different to those that might arise for large companies, multi nationals, and corporate groups.

1.2. This is an area of particular interest to LITRG due to the increasing number of people trading through a company but who frequently do not understand what this entails. They often fail to appreciate the separate legal status of the company and struggle to differentiate between the company and their own personal affairs. There is also often confusion between the different roles and requirements of Companies House and HMRC.

1.3. This general lack of understanding of how a company operates can have serious consequences as both corporate and personal compliance then fall behind and penalties are likely to be incurred. This can all have a significant impact on the owners/directors, as it is often a stressful experience.

1.4. By April 2026, the earliest proposed date for the introduction of MTD for CT, most VAT registered companies will already have digital record keeping processes in place to comply with the Making Tax Digital for VAT (MTD for VAT) regime. We believe further consideration needs to be given to how the record keeping requirements for MTD for CT and MTD for VAT overlap or diverge; companies already keeping digital records for MTD for VAT cannot be

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expected to keep different records for MTD for CT and so alignment of the two should be given urgent consideration.

1.5. It seems it will be the smallest businesses (who do not come within the scope of MTD for VAT) that may well need to make the biggest changes if they are to comply with MTD for CT in due course. We are concerned that businesses who may need the longest time to prepare to be compliant with MTD for CT, will have the least resources available to assist them. Often such businesses do not engage professional tax agents, will not have separate accounting staff and have limited IT equipment and software. We fear that for many small companies, complying with all the proposed requirements of MTD will be very time consuming, and so may not meet the stated intention of freeing up time to enable the business to be developed.

1.6. Small trading companies with low turnover are likely to find the requirements of MTD for CT to be disproportionately burdensome and costly. We strongly recommend there should be an exemption for the smallest businesses as there is for small self-employed businesses under the Making Tax Digital for Income Tax Self Assessment (MTD for ITSA) regime as we believe that the same reasons which make an exemption threshold relevant for income tax also apply in the context of corporation tax. The turnover exemption should be at least £10,000 (in line with the MTD for ITSA regime), although in our view it should be higher than this. A higher threshold should then avoid bringing into scope the small companies which will find the additional administration very burdensome rather than a benefit to their business.

1.7. It is important that sole director/shareholder companies whose director is digitally excluded can apply for exemption from MTD for CT, in a similar way that digitally excluded individuals can apply for exemption from MTD for ITSA or VAT. We are very pleased to note that paragraphs 6.9 and 6.10 of the consultation document confirm this will be the case. In companies where there is more than one director, we assume that the company will be able to apply for exemption if all directors are digitally excluded.

1.8. MTD for CT should not force small businesses into needing more help and support from their agents to the extent that the increase in professional fees outweighs any of the apparent benefit from the digitisation process. For the 15% [1]of companies which do not have a tax agent, it is important that this major change in reporting information to HMRC does not drive these companies into engaging professional help solely because they need support to comply with MTD for CT.

1.9. We anticipate that those who are less digitally capable may have to make a transition from paper-based records to a spreadsheet based record keeping system (which they might be

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[1] Paragraph 1.27 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934638/Making_Tax_Digital_-_Corporation_Tax.pdf

able to maintain perhaps with the help of a friend or family member) but they may not be able to cope with a full bookkeeping software package. Therefore, bridging software, similar to that currently available for MTD for VAT, will be required, and we seek confirmation that this will be factored into the MTD for CT software planning.

1.10. We are concerned that at present there is no firm commitment to ensure free software is available for MTD for CT as there has been with MTD for VAT and ITSA. HMRC should also commit to making sure free MTD compliant software is available when MTD for CT becomes mandatory so that companies can choose to use software to meet their MTD obligations without incurring significant software costs. As well as free software, HMRC should ensure that available software will be compatible with forms of assistive technology to ensure that those with disabilities are able to comply with their obligations and do not have additional costs imposed due to their accessibility needs.

1.11. In our experience, some accounting software packages can appear very complex to those running small companies. This means that it is easy to make a mistake if you are unfamiliar with them and not an experienced bookkeeper. This complexity should not be underestimated.

1.12. Some people, although not digitally excluded, may have difficulties dealing with digital requirements and require assistance. We call on HMRC to assure companies who are not digitally confident that there is no intention to penalise them where they make a genuine error, especially if there is no tax impact after the final corporation tax return has been submitted. We would expect HMRC to provide extensive support and guidance to help the companies that are digitally challenged to comply with MTD for CT.

1.13. The free Company Accounts and Tax Online (CATO) service, primarily used by unrepresented companies with low turnovers, should be maintained, even when MTD for CT software products become available.

2. About Us

2.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

2.2. LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3. The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3. Introduction and general comments

3.1. We are pleased to be able to comment on the proposals for Making Tax Digital for Corporation Tax from the perspective of small trading companies with modest profits. This will be the last of the main taxes to come within the Making Tax Digital programme, the aim of which is to close the tax gap by introducing a fully digital tax system which works as close to real time as possible. We note that the proportion of the tax gap attributable to avoidable errors by companies in relation to corporation tax is estimated at £2.1 billion out of a total of £8.6 billion.[1]

3.2. HMRC statistics show that over 60% of the 2.8 million corporation tax returns submitted in the 2018/19 financial year were from companies with turnover below the VAT registration limit of £85,000, and that just over 1 million companies had corporation tax liabilities of less than £10,000[2]. Therefore, the proposals in this consultation will potentially apply to a significant number of small companies, many of whom will be sole director/shareholder or perhaps family trading companies, with expertise in their own fields of work but often with limited understanding of the company structure itself.

3.3. Although many of these companies will have been set up on the advice of an accountant/agent, in our experience these companies are also formed in one of three other ways:

- the director mistakenly believes that they have to have a company to run a business (often because of the perceived protection of limited liability);
- the person setting up the company is told that they have to have a company to be able to get the work they want;
- an agency worker is passed to an umbrella company by an agency which outsources its payroll, and the umbrella company puts them into a limited company.

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[1] Paragraph 1.19
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934638/Making_Tax_Digital_-_Corporation_Tax.pdf

[2] Page 16

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934638/Making_Tax_Digital_-_Corporation_Tax.pdf

Typically, these may range from tradesmen to IT contractors, and teachers to nurses with very varying levels of financial literacy. In our experience, most who fall into one of these three categories do not appreciate the separate legal status of the company and struggle to differentiate between the company and their own personal affairs. There is also often confusion between the different roles and requirements of Companies House and HMRC. This can frequently lead to some difficult compliance problems that need to be resolved.

3.4. It has never been easier or cheaper to set up a company and government statistics show that between July and September 2020 there were over 221,000 new companies added to the Company Register, an increase of over 30% on the same period in 2019.[1] It is believed that some of the growth in company formations recently has been due to people losing their jobs in the pandemic and so setting up a business instead. [2] It is likely that a sizeable proportion of the new companies will be small companies that fall into the first bullet point at paragraph 3.3.

3.5. Approximately 85%[3] of companies engage an accountant/agent to assist them with complying with their legal and tax related obligations. Even the smallest companies will usually engage an accountant to prepare their annual statutory business accounts and company tax return. The extent to which the directors rely on the agent to deal with company matters will vary from business to business depending on factors such as cost, time available, digital capability and financial confidence. It is important that MTD for CT does not force small businesses into needing more help and support from their agents and consequently incur increased fees, so that they do not see any of the apparent benefit from the digitisation process.

3.6. This means that 15% of companies do not currently engage an agent, and this is a significant number of companies who will be expected to move to MTD for CT without external advice or support. We anticipate that these companies will often be classed as small and will fall into the first two categories listed at paragraph 3.3 above. It would be wrong if these companies have the additional cost of engaging professional advisers **solely** to comply with the MTD for CT requirements.

[1] https://www.gov.uk/government/statistics/incorporated-companies-in-the-uk-july-to-september-2020/incorporated-companies-in-the-uk-july-to-september-2020

[2] See article in Financial Times, 19 Oct 2020, entitled 'UK businesses being set up at record rate, register says' https://www.ft.com/content/cbb844f2-b852-4b83-bc7d-f87476cfafca

[3] Paragraph 1.27, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934638/Making_Tax_Digital_-_Corporation_Tax.pdf

3.7. According to HMRC's figures, approximately 60%[1] of small companies do not currently use software to maintain their business records. If a small company is not already using digital record keeping software it will either be using a spreadsheet based or paper-based record keeping system. Those who are not very digitally capable are likely to have paper-based records, and so moving to digital record keeping will be a very big step. For many who fall into this category, the best 'next step' for them will be moving to a spreadsheet-based system, akin to a digitised cashbook, as a move to a full software package may be too big a leap to make. Those currently using spreadsheets may decide to continue with them, or possibly some may decide to move to a full software package.

3.8. For those who keep digital records using spreadsheet packages there will clearly be a need for bridging software similar to that available for MTD for VAT to deal with filing any returns they may be required to make. We urge HMRC to ensure that bridging software will be available to meet the MTD for CT requirements. HMRC should also commit to making sure free MTD compliant software is available when MTD for CT becomes mandatory so that companies can choose to use software to meet their MTD obligations without incurring significant software costs. At present we understand that there has been no commitment from software providers to produce free software to enable the smallest, simplest companies to follow these proposed requirements, and we consider that free software should be available in due course.

3.9. HMRC should also ensure that available software will be compatible with forms of assistive technology so that those with disabilities are able to comply with their obligations and do not have additional costs imposed due to their accessibility needs.

3.10. We are very wary of relying on the commercial software market to provide free products as they are likely to have significant limitations such as minimal technical support, a short time limited 'free' period and/or continual pressure to upgrade to 'paid for' software in many instances.

3.11. In our experience it cannot be underestimated how complex some of the software packages can appear to be and how easy it is to make a mistake if you are unfamiliar with them and not an experienced bookkeeper.

3.12. There is also a perception that all digital accounting and reporting can be done using a smartphone. While commercial advertising might lead us to believe this is what everyone is doing, in reality we understand very few businesses currently use their smartphones to manage their business affairs. There are clear drawbacks to assuming this is the easy and convenient way forward for most businesses, for example, there are still many areas of the

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[1] Paragraph 3.2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934638/Making_Tax_Digital_-_Corporation_Tax.pdf

UK where mobile reception is unreliable, and phone data charges may restrict use at certain times.

3.13. We agree that it would be helpful to include claims and elections as part of the MTD for CT process, but we feel strongly that this should not be prescriptive and there must be other accessible ways to make any relevant claims and elections. In addition, there must be scope to change any such claims and elections via the company tax return if the company so wishes.

3.14. We can see the benefit to HMRC on having more up-to-date information provided by MTD for CT, but the benefit it will bring to the companies themselves is a bit less clear. Only 51% of respondents to the Thomson Reuters survey referred to at 1.17 of the main consultation document reported having 'simplified or more efficient processes' as a result of MTD for VAT. Further, we do not think these proposals fit with HMRC's Charter which states 'We'll provide services that are designed around what you need to do, and are accessible, easy and quick to use, minimising the cost to you'. HMRC should explain how MTD meets these Charter commitments, especially with regard to accessibility, where people must find third party software to be able to comply with their tax obligations.

3.15. We consider it important that HMRC continue to learn from the roll out of MTD for VAT and also the MTD for ITSA pilot in order to help companies with this significant change to their reporting requirements. HMRC should proactively encourage companies of different sizes and sectors and those without professional representation to join the pilot to MTD for CT in due course to help identify any issues before its launch.

3.16. We note that the impact assessment in section 7 of the consultation document[1] states HMRC do not anticipate that MTD for CT will have an impact on individuals. We do not agree with this, and this response highlights several circumstances where we believe individuals, as directors of a small company, will find complying with the MTD for CT process difficult. This will inevitably lead to some directors being personally impacted in some cases due to the stress and worry they could feel. This will particularly be the case if they cannot afford to pay for tax advice.

3.17. Our comments below are responding to the questions raised in the online survey launched as part of the consultation process and specifically aimed at small businesses. We have only addressed the questions where we consider we have relevant points to make.

4. Online survey questions

[1] Page 37, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934638/Making_Tax_Digital_-_Corporation_Tax.pdf

4.1. **Are there any reasons why any one type of business within the charge to CT may find it more difficult than others to meet MTD requirements?**

4.1.1. Small trading companies with low turnover are likely to find the requirements of MTD for CT to be disproportionately burdensome and costly (both financially and in opportunity cost for the time spent adapting to MTD for CT). We strongly recommend there should be an exemption for the smallest businesses as there is for small self-employed businesses under the MTD for ITSA regime as we believe that the same reasons which make an exemption threshold relevant for income tax also apply in the context of corporation tax.

4.1.2. The turnover threshold for the MTD for ITSA regime is £10,000. Therefore, we would expect exemption from MTD for CT to be at least equal to this. However, we think the threshold for MTD for ITSA is too low. the exemption threshold should be set at a higher level for MTD for CT, so that the small companies which will find the additional administration very burdensome rather than a benefit to their business are not within scope.

4.1.3. Also, we believe provision should be made for companies whose sole director/employee is digitally excluded to be exempt from MTD for CT, in a similar way that the self-employed can apply for exemption if they are digitally excluded. We are very pleased to note that paragraphs 6.9 and 6.10 of the consultation document confirms this will be the case. In companies where there is more than one director, we assume that the company will be able to apply for exemption if all directors are digitally excluded.

4.1.4. Guidance explaining how companies can apply for exemption from MTD for CT needs to be clear and published in sufficient time to enable applications to be made for this exemption before April 2026. Applying for exemption must not be a purely digital process.

4.1.5. We assume dormant companies will not be included in MTD for CT but consideration will need to be given to how a company which has been dormant but then starts trading will 'join' the MTD for CT regime and in particular, fit into the proposed quarterly reporting cycle.

4.2. **Do you agree with the minimum categorisation for MTD compatible software?**

4.2.1. In 3.7 above we identified what types of companies we expect to move to full software packages for record keeping and MTD compliance. We stressed how complex some of these packages can be to use for non-accountants and as many small companies have no additional staff to provide accounting support, and 15% of companies do not engage an agent, this could result in a significant burden on sole director companies to understand and correctly use the MTD for CT software.

4.2.2. There are almost 30 categories of income and expenditure listed in the proposed breakdown of data. Many of these are similar and so could be confusing to the non-accountant company director. Lots of transactions could get mis-posted even if there is good guidance within the software as to what needs to be included under each category. Nudges and prompts within software might help reduce the number of mis-postings but this is an area which falls squarely with the software developers and so is inevitably difficult for HMRC to influence to any great degree. We are concerned that not all software packages will include this additional assistance, through nudges and prompts, and the ones that do may not be free or affordable for small, unrepresented companies.

4.2.3. It would be better to have a much simpler list of categories for companies with low turnover who are not exempt. In our view it would be sensible to match the Standard Accounts Information (SAI) categories which small unincorporated businesses will use under MTD for ITSA for companies with turnover below the VAT registration limit.

4.2.4. We call on HMRC to assure companies who are not digitally confident that there is no intention to penalise them for misposting transactions in genuine error, especially if there is no tax effect after the final corporation tax return has been submitted. We would expect HMRC to provide extensive support and guidance to help the companies that are digitally challenged to comply with MTD for CT.

4.3. **Do you agree that the update cycle for a business should be based upon its expected accounting period? Do you agree that the updates should be due one month after each quarter end?**

4.3.1. We agree that it seems sensible to align quarterly updates with the accounting period, however there will need to be some inbuilt flexibility to cope with situations where there is a short or long accounting period. In our experience, it is only usually the first accounting period which may be a long or short period with small companies, as thereafter they tend to continue with 12-month accounting periods. (Larger businesses are more likely to change accounting dates, for example when there are mergers or for tax planning reasons.)

4.3.2. However, consideration will need to be given to when companies that are initially outside the scope of MTD for CT, but which come within it at a later date, begin their quarterly updates. This includes, for example, a dormant company that begins trading, or an exempt business that becomes non-exempt. The process will also need to be able to cope adequately with companies who fall in and out of the scope of corporation tax over a period of time, for example an existing trading company ceases trading for a period because the director gets PAYE employment, but then when that ends the company is reactivated and begins trading again.

4.3.3. A due date for the quarterly returns of one month after the end of the quarter seems reasonable, although we note it does not align with the VAT due date of one month and 7 days after the VAT period end. This creates additional complexity.

4.3.4. The quarterly updates should not allow for accounting adjustments to be made each quarter for things like accruals, depreciation etc as this will effectively mean that quarterly accounts will need to be drawn up each time, which is far too onerous a requirement. Accounting adjustments should be made when the year-end accounts are prepared.

4.3.5. As has been noted at 3.5 above, the majority of companies engage an accountant/agent to assist them with complying with their legal and tax related obligations. If the company is VAT registered and so complying with MTD for VAT, they may deal with their VAT returns themselves, perhaps to try to reduce professional fees, and so they may be able to produce basic quarterly returns too. But these companies will need to understand if the information they are recording for MTD for VAT is sufficient for MTD for CT or if there is additional information to record.

4.3.6. For non-VAT registered small companies, the imposition of quarterly returns is likely to mean involving an accountant four times each year rather than once per year with the associated uplift in professional fees. If the accountant is involved in submitting quarterly returns then this is likely to reduce the amount of time spent preparing the end of year accounts, but the reduction will not be commensurate with the cost of four quarterly returns.

4.3.7. Those who cannot afford this increase in fees will have to try to prepare the quarterly returns themselves and then their accountant will have to correct any errors as part of the year end work. This may result in an increase in annual fees if there are many errors made by a director who is confused by the quarterly returns and makes mistakes posting transactions.

4.3.8. Unrepresented companies will also have to consider whether they can afford suitable software which will provide sufficient guidance and support to enable accurate quarterly reports to be prepared. We understand that there is currently no commitment for any free software to be provided to companies, we would urge HMRC to ensure that free MTD compliant software is available (see our comments at 3.8 and 3.9 above and also our comments at 4.5 below).

4.3.9. We have explained above that we believe many small companies will use spreadsheets to meet the digital record keeping requirements. They will then need bridging software to file the quarterly updates. This has been acknowledged and catered for within both the MTD for VAT and the MTD for ITSA space. Assuming bridging software becomes an option within the MTD for CT regime, it is not clear how the statutory accounts will then be prepared and filed at Companies House. Will further additional software be required? Paragraph 5.6 of the main consultation document mentions linked software – what is this likely to be? Further work needs to be done to ensure that the full compliance process can still be completed where spreadsheets are used as the main primary digital record.

4.4. **Do you agree it is appropriate to align the filing dates of the CT return and Companies House accounts?**

We support simplifying the accounting and tax systems wherever possible, and this may well be a sensible step for small companies, but it is unlikely to be suitable for larger companies where the tax computation cannot be finalised until after the accounts have been formally approved.

4.5. **Do you agree that the CATO service should be retired once the MTD for CT software products are widely available?**

No, we do not think it should be taken down once MTD for CT is mandatory. We understand that around 16,000 submissions are made via the free Company Accounts and Tax Online (CATO) service every year, primarily by unrepresented companies with turnover below £10,000. It is particularly useful as it incorporates filing accounts with Companies House.

4.6. **What expenditure do you expect (businesses) to have to make to meet the requirements of MTD for CT?**

4.6.1. *New equipment (computers, scanners, tablets etc)* – this is undoubtedly expenditure which some small businesses will have to incur for the first time. Others may feel they need to upgrade to newer equipment if they can afford to do so, if they have to rely on it to make regular submissions to HMRC.

4.6.2. *Additional staff/staff training* – we think it is unlikely small companies will choose to hire staff to comply with MTD, they are more likely to try to deal with the additional administration themselves. There are unlikely to be staff or staff training costs, however there will be a cost to the director while they train themselves in the use of new technology and software in terms of time spent.

4.6.3. *New or upgraded accounting (record keeping) software and/or filing software* – we expect it to be very likely that small companies will need to buy accounting and/or filing software to enable them to comply with MTD for CT. Those who are less digitally capable may have to make a transition to a spreadsheet based record keeping system (which they might be able to maintain perhaps with the help of a friend or family member) but they may not be able to cope with a full bookkeeping software package. Clearly if they opt for spreadsheets then they will also need some kind of bridging software too (if it is possible to use bridging software to comply with MTD for CT).

4.6.4. *Paying an agent or external bookkeeper* – This will almost certainly be an additional expense for just about all small businesses. This is because many who do not have the skills, time or confidence to move to electronic record keeping themselves will rely on their accountant to maintain their digital records and file their quarterly returns, thereby increasing their costs. Others may be nervous about making the quarterly submissions even if they feel they can manage the record keeping aspect (probably via a spreadsheet) and so they will rely on an agent to either check their submission or actually make the submission for them.

LITRG
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