

Getting your financial house in order

How will changes to the VAT penalties regime and Making Tax Digital for Income Tax affect independent pharmacies?

Atif Butt examines two recent announcements from HMRC...



In November 2022, HMRC announced sweeping changes to the VAT penalty regime. For all VAT periods from 1 January 2023 there is now a new system for charging penalties on late VAT returns.

Under the previous rules, VAT penalties were charged under the default surcharge scheme when a VAT return was submitted late and any VAT due for payment was not made in time. The amount of the penalty was calculated as a percentage of the underpaid VAT, and would increase depending on how late your return and payment were, and whether you'd been late in the past.

As pharmacy businesses tend to reclaim VAT rather than make VAT payments to HMRC, it was unusual for them to be charged a penalty under the old scheme, even in cases where their returns were persistently late.

However, the new penalty regime applies where VAT returns are submitted late or VAT is not paid by the due date. It adopts a new approach where businesses receive a penalty point each time a VAT return is submitted late.

Once the business reaches a set number of penalty points (determined by the frequency of their VAT returns), penalties will be charged by HMRC starting at £200, with an additional £200 penalty for each subsequent late submission.

If you do quarterly VAT returns, penalties will start once you get four points, and if your VAT returns are monthly, they start at five points. If a business stays below this threshold its points will expire automatically after 24 months, but if it reaches the threshold the points only expire once it has filed all its returns on time for a 'period of compliance' determined by HMRC.

To allow VAT registered businesses to get used to the new regime, HMRC won't charge a first late payment penalty during 2023, as long as businesses pay any VAT due within 30 days of the due date.

For pharmacy businesses it has always been important to submit VAT returns as soon as possible so that they can get their VAT refunds quickly, as this helps the business cash flow. But under the new penalty regime being persistently late with your returns could become costly as the penalties keep mounting up.

MTD for ITSA changes

Last December, HMRC also announced changes to the start date and eligibility criteria of Making Tax Digital for Income Tax Self-Assessment (MTD for ITSA).

MTD for ITSA is the next stage in the government's plan to digitalise the UK tax system that started with changes to the VAT system in 2019.

The new rules will change the way the

self-employed and landlords submit their income tax returns, and as such it will affect those pharmacy businesses that operate as sole traders and are paying income tax, as well as pharmacy owners with property income over the threshold.

The changes were originally scheduled to come into effect from April 2023, but this has now been postponed to April 2026 for all businesses earning over £50,000, and to April 2027 for all businesses earning over £30,000.

HMRC had also previously announced that the MTD rules would apply to partnerships in 2025 and would be extended to limited companies following that, but this has also been delayed, with new start dates still to be announced.

So, what will the new rules mean when they do come into effect? Under the current rules sole traders and landlords file an annual self-assessment tax return to declare their income and the tax due. To comply with the new MTD for ITSA rules they will need to use MTD-compatible software to send HMRC the following each year:

- Four quarterly updates, reporting details of income and expenditure for each quarter directly from the digital records in their accounting software.
- An End of Period Statement including any final adjustments to the accounting data.
- A Final Declaration due by 31 January of the following year, where the business can declare other sources of income (like savings and investment income) and submit claims for reliefs.

Like the MTD rules for VAT, to comply you'll need to be using compatible accounting software and keeping digital records. If you haven't already done so, your accountant will be able to advise you on how you can make the necessary changes.

Despite the postponement of MTD for ITSA, it still makes sense to do this as soon as possible as moving to the right accounting system can help you get better quality accounting information with less effort and at a lower cost.

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