



HM Revenue
& Customs

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Chief Executive and First Permanent
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Dame Meg Hillier MP
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Dear Dame Meg,

Following the Public Accounts Committee session on Monday 19 June 2023, attended by Jo Rowland, Jonathan Athow and myself, I am writing to provide further information that Jonathan committed to send to the Committee and corrections to oral evidence.

Tax-deductibility of business costs incurred in Making Tax Digital for Income Tax Self-Assessment

We have taken your question to refer to the costs unincorporated businesses may incur under Making Tax Digital for Income Tax Self-Assessment.

HMRC continues to work with the software industry to ensure that businesses will have access to affordable software products. The government has committed to there being free software products for the smallest businesses with straightforward affairs.

If a business incurs costs associated with MTD that are wholly and exclusively for the purposes of the business, and are revenue in nature, then these costs will normally be fully tax deductible under general principles. Capital costs incurred by a business that are associated with MTD may be tax deductible through capital allowances, depending on what has been purchased.

In particular, some businesses may incur costs associated with the licensing of software, or may pay for additional support from their accountant or advisor to meet the requirements of MTD ITSA. As long as these costs are wholly incurred for the purposes of the business, they are normally fully tax deductible in the year that they are incurred.

There may be some specific circumstances where these deductions are spread over a number of years, or where the costs are not deductible; I have set out the treatment of these costs below.

Software

If a business pays regular payments for a software license, such as monthly or annual subscription, then these costs will normally be revenue in nature and so fully tax deductible in the year that they are incurred.

If a business pays a lump sum for a software license, then the useful life of the software needs to be considered to determine whether the expenditure is capital or revenue. The costs of a software license with an expected useful life of less than two years will normally be revenue in nature, meaning that they are fully tax-deductible.

If the software is expected to have a useful life of more than two years, then the costs are likely to be capital in nature. In these circumstances, the software will qualify for capital allowances.

Businesses may be able to get a full tax deduction in the year the costs are incurred if they are eligible for Annual Investment Allowance (AIA), which is limited to £1 million per year. Businesses that have exceeded their AIA limit and that incur capital costs on software will be able to claim capital allowances to get a tax deduction of 18% of the cost of the software per year, until the cost of the software has been relieved.

Therefore, in both cases of revenue and capital expenditure, the costs of acquiring business software are normally fully tax-deductible; there may be some differences in the timing of the deduction, based on whether the expenditure is capital in nature and whether the business has any of its AIA limit to use.

Further information on the tax treatment of costs associated with software is available in HMRC's Business Income Manual at BIM35800.

Accountancy and Advisory Fees

A business might also incur costs associated with additional accountancy or advisory services that they use to meet the requirements associated with MTD. Where these fees are wholly and exclusively for the purposes of the business, and are revenue in nature, they will be fully tax-deductible in the year that they are incurred.

Further information on the tax treatment of costs associated with professional fees is available in the Business Income Manual at BIM46400.

Corrections to oral evidence

Q43: I said the number of people in the pilot was 237, the correct figure is 137, as Jo Rowland replied in response to Q22.

Q46: I said the Office for Budget Responsibility had scored on the fiscal and economic scorecard £138 billion over the five years to 2023-24 for that first mandated cohort instead of £1.38 billion. This latter figure was a provisional estimate. Most recent estimates made at Spring Budget 2023 are that these benefits would have been £1.495 billion over the five years to 2023-24 for that first mandated cohort and a further £100 million from the second cohort, which were much smaller businesses. The Office for Budget Responsibility certified £2.6 billion of VAT additional revenue covering the years 2022-23 to 2027-28.


Q57, 73 and 74: Jonathan Athow and I referred to HMRC 'accrediting' or 'certifying' MTD software. HMRC has a recognition, rather than accreditation, process for all software products, including MTD. Recognition gives HMRC and the software user confidence that the product meets HMRC's requirements, and that it can successfully interact with our services.

Q63: I stated there would be 1.6 million new customers, it is possible some of these 1.6 million customers in the market will already have software from these providers and therefore not be 'new'.

Q80: Jo Rowland said the population is around 12.7 million, the correct figure is around 12 million.

Q85: I said HMRC had reviewed 200,000 records, the correct figure is tens of thousands.

Yours sincerely,



Jim Harra
CHIEF EXECUTIVE AND FIRST PERMANENT SECRETARY