

MTD ITSA – The income exemption (Lecture B1278 – 12.07 minutes)

The digital obligations which relate to MTD for income tax encompass:

- The requirement to keep digital records
- The requirement to provide 'periodic' (quarterly) updates and
- The requirement to provide an end of period statement.

The broad basis of these obligations was legislated for in 2017 in Finance Act 2017 s60, which inserted Schedule A1 into TMA 1970. The Regulations are made under Sch A1, setting out more detail on the requirements. They will be supplemented by tertiary legislation setting out the precise content and requirements of the elements of the legislation set out below.

Income limit

The income limit further determines whether the taxpayer is required to comply with this legislation once their digital start date has passed. The Regulations are a little complex on first reading, but that is to prevent taxpayers dipping in and out of MTD as their income fluctuates. In essence a taxpayer's businesses can only drop out of MTD once their income has been below the limit for three consecutive years – see below. The details of the income limit are dealt with by Regs 21 to 23 and are described as the Income exemption.

Gross income

The income exemption refers to the "amount of the person's qualifying income". This is defined as the sum of the amounts of income before any deductions for each business carried on by the person in the tax year, and for which the amounts are included in the Self Assessment (or equivalent) for that year. Given that income from a property is regarded as a 'property business' this means:

- Turnover from all trading activities, and
- Gross rents and other income received from property (including an overseas property business)

Regulation 21(6) requires the amount used to be annualised if the period included on the return (or equivalent) is a period of other than 12 months. This may produce an upward adjustment for short periods, or a downward adjustment for long periods, for example when a trade has a long period of account to cover a change of accounting date.

Structure of the exemption

For the income exemption to apply, Reg 21(3) requires two tests to be met:

1. The digital requirements did not apply to the person in the previous tax year, and
2. The gross income for the tax year for which the filing deadline fell before the start of the tax year in question was less than £10,000. (I will call this the 'relevant year').

So for the first year of MTD, those taxpayers not needing to comply with the rules will identify as follows :

- Not required in previous year – applies to all;
- Gross income for the relevant year below £10,000. The relevant year is the year for which the filing deadline is 31 January 2024 (immediately before the start date for MTD). This is the filing deadline for 2022/23, so that is the year used for the entry into MTD from the start date of 6 April 2024.

So the base year for income test for the start of MTD will be 2022/23.

For businesses not coming in from the start of MTD and for new businesses, it will be necessary to follow the logic above once the digital start date has been passed for new businesses – until that date the exemption is not relevant.

Persons acquiring the income exemption subsequently

Where a person has been subject to the MTD requirements, they will only become exempt under the income exemption when the last three years have been below the income limit. So for example, a business joining MTD in 2024/25 (the commencement year) would remain in MTD until three complete years have passed during which their income was below the £10,000 limit.

For the first two of those years, it will be the income according to the End of Period statements for the basis period. For the third of those years, it is based on the quarterly filings for that year, as the End of Period statement is unlikely to have been filed for that third year before the person wishes to claim the exemption. Any period in which the period reported is not 12 months should be scaled accordingly.

Electing to disapply the income exemption

A person can elect that the income exemption does not apply to them by notifying HMRC before the start of the tax year in which they would otherwise be exempt. The exemption would then not apply for the next tax year and all subsequent years unless the exemption is withdrawn.

A notice of withdrawing the exemption must specify the date of withdrawal, and the exemption will then apply from the following tax year.

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