

What to do when a Section 16 Notice arrives

What is a Section 16 Notice?

The Revenue can issue a notice under Taxes Management Act 1970, section 16 to demand a return of payments made in the course of a trade or business for services, commissions or copyright royalties that are paid gross to persons other than employees.

Why is it used?

The powers under TMA 1970 section 16 were originally introduced in 1956 to collect details of payments made to entertainers and sportsmen, who it was thought were like to receive irregular large sums which were not taxed at source and may fail to make their way on to a Tax Return. Section 16 notices are still regularly issued to companies operating in the entertainment industry, but nowadays such notices are an ideal way for the Revenue to collect information about businesses potentially caught by IR35 or who may not operate fully within the taxed economy.

Who is it issued by?

In the past most section 16 notices were issued by the Revenue Taxes Information and Distribution Office (TIDO) that contains special units for collecting information on payments to entertainers, mail order catalogue agents, and insurance agents who may receive irregular amounts of commission. The specialist Revenue unit dealing with the agricultural industry uses TMA 1970 section 16 to compile information on payments to 'gang-masters' for labour. The advice to local Inspectors in the Assessment Procedures manual at paragraph 3691 was to use TMA 1970 section 16 only sparingly to ask about commission payments and expenses, but that restriction appears to have been overruled in view of the large number of section 16 notices now in issue.

Who can it be issued to?

Section 16 notices can be issued to:

- An individual;
- A company at its registered office;
- Acting partner of a partnership; and
- Friendly, industrial or provident society at its registered office.

Section 16 notices may also be issued to the treasurer of bodies such as charities or unincorporated associations that carry on non-business activities but who have made payments for services in the course of those non-business activities.

In the last year most of the clearing banks and major utilities have received section 16 notices together with companies in a range of industries who regularly employ subcontractors.

What does it cover?

The provisions in TMA 1970 section 16 were drafted to require details of payments to one supplier that exceeded £15 in a year. Although this de-minimise figure has not been raised, the current practice of the Inland Revenue is to request details of payments only where the total amount paid to one person in the period exceeded

£1000. 'Payments' include valuable consideration in any form so barter or contra deals must be reported and all payments of expenses paid to non-employees.

The details to be returned under TMA 1970 section 16 must include, for *every payment*:

- The amount;
- The business name and business or home address of the payee; and
- A description of the service and the period covered by the payment.

The information requested is not limited in the provision of personally performed services, all services rendered in the course of the business by persons not employed by the business are included. Thus a huge range of services is potentially required to be reported; from window cleaning, to legal advice, door security, to IT consultants. The task of extracting the details of every single relevant invoice for services and compiling the return required would be significant even for a medium sized organisation.

What it does not cover.

TMA 1970, section 16 cannot be used to request copies of contracts for services, or other documents. If the Inspector wishes to examine contracts with named parties as part of an enquiry he must request that the documents are delivered under TMA 1970, section 19A.

What period?

Section 16 notices are currently being issued for the tax years ending 5 April 2001 and 5 April 2002, but the notice can require a return to be made for any period to cover payments made in tax years ending within the three years of the issue of the notice. If the recipient organisation does not compile its accounts on a fiscal year basis it is possible to arrange, with the prior agreement of the Inspector, to complete the return for a period which is coterminous with its accounting period.

How to provide the information?

The Inland Revenue provide a standard form: 46G to return the details required by a section 16 notice. However the Inland Revenue Inspectors Manual recommends that the required information should be accepted in an electronic or magnetic media format. A commonly acceptable format is an Excel spreadsheet. Details of payments to self-employed workers in the entertainment industry are required to be reported on the form 46R-1.

What do they do with the information?

The Inland Revenue can use the information given in section 16 returns to examine tax returns from the supplier businesses named. It will also compare the totals given to the accounts of payer to check that the expenses and commissions paid are shown in the accounts. This check can uncover sweeteners or bribes that should be disallowed in the tax computation.

Time limit

The time limit for complying with the section 16 notice will be specified in the notice, and is usually given as 30 days, although this will normally be negotiable. In the past

the Revenue has been fairly lax in chasing up returns required under TMA 1970, section 16 and has rarely imposed penalties for non-compliance. That approach could quickly change as Inspectors realise the value of the information gathered, and develop systems to sift and process the large volumes of data delivered by big businesses.

Penalties

In the case of non-compliance with a section 16 notice the Revenue may apply to the Court or General Tax Commissioners to impose a maximum penalty of £300. If the information is still not produced the Inspector can impose a daily penalty of up to £60, once the Court has declared the first penalty is due. If the section 16 return is completed negligently or fraudulently so it includes incorrect information the recipient of the notice can be subject to a penalty of up to £3,000. As always it is up to the recipient of the notice to ensure accuracy and bear the costs of providing the information.

Conclusion

Revenue has very broad powers under TMA 1970 section 16, and it has indicated that it will use them to obtain details from agencies and employers, of payments made to service companies and other contractors. Most well organised agencies used to dealing with labour only contracts will be able to supply this information readily, but other companies may not distinguish payments for services to those for goods in the accounting system.

If your client is issued with a section 16 notice, the best policy would be to negotiate a reasonable time frame for compliance with the Inspector.

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