

Supervision, Direction and Control (SDC) explained for contractors

Contractors now need to have an understanding of how HMRC's rules on Supervision, Direction and Control (SDC) work, as the taxman is planning to widen their use for new and updated legislation on [IR35](#) and expenses.

"The test of supervision, direction and control is currently used by HMRC to determine whether the 'agency legislation' applies to workers," explains [Andy Vessey, Qdos Consulting's](#) tax investigations expert.

"Contractors will understand some aspects of SDC, as it is essentially a subset of the control test used for determining employment status according to the IR35 legislation."

An understanding of SDC may become an essential part of a contractor's tax toolkit, as HMRC is proposing to use it to determine whether contractors are eligible for expenses tax relief and as a possible replacement of IR35's existing tests of employment.

What legislation does SDC originate from?

SDC is used to determine employment status in a collection of legislation that has become known as the 'agency legislation'. According to Vessey, the source legislation is:

Part 2, Chapter 7 [Income Tax \(Earnings and Pensions\) Act 2003](#), Part 2, Chapter 7, section 44(2)(a)

[Social Security \(Categorisation of Earners\) Regulations 1978](#), Schedule 1, Part 1, paragraph 2

"The Agency Legislation requires an agency or an employment intermediary to consider an individual's self-employed status. Should they be subject to SDC, then they must be placed on the payroll.

"The legislation was updated in 2014 following the consultation on Onshore Intermediaries ([False Self-Employment](#)) legislation. The Onshore Employment Intermediaries legislation requires an agency or employment intermediary to report, on a quarterly basis, those workers where it did not operate Pay As You Earn (PAYE). It was during the debate as to whether these rules applied to contractors that the contracting sector would have become more familiar with SDC."

There is an established body of [HMRC guidance for the agency regulations](#) in its Employment Status Manual (ESM), alongside specific provisions for limited company contractors, or [personal service companies](#) to use the taxman's label. This includes [examples of different types of agency worker](#), including [IT contractors](#).

SDC is a subset of the broader 'control' test, as used for IR35

"SDC is one of the four key components of the control test," continues Vessey. "Contractors should be familiar with control being broken down into 'what' work is done, 'when' it is done, 'where' it is done and 'how' it is done from their experience of IR35.

"SDC homes in on the 'how' aspect, which in turn is broken down into the 'supervision', 'direction' and 'control' over how the work is completed.

"A key feature of SDC in the context of the agency legislation is that there is no requirement for any kind of control to be exerted. There merely needs to be the right of SDC to exist for it to apply. If SDC is extended to other legislation, then this is likely to be the same."

What, specifically, are Supervision, Direction and Control (SDC)?

Vessey explains what each component means:

"For **supervision** to apply there must be someone overseeing another person doing the work to ensure that they are actually doing it and that the work is being done correctly to the required standard. Supervision can also involve aiding or assisting someone to develop their skills and knowledge.

"**Direction** involves someone making another person do their work in a certain way, generally by providing instructions, guidance and advice as to how the work is to be done. Someone providing direction will often coordinate how the work is done as it is being undertaken.

"**Control** is where you have someone dictating what work a person does and how they should go about doing that. This also includes the power to move the worker from task to task as priorities change.

"Another key point is that a contractor is caught by SDC if any one of the three elements apply. So, a contractor may not be directed or controlled, but if they are supervised according to the above criteria, or if there is the right of supervision, then SDC applies."

HMRC [provides its own explanation](#) of what "supervision, direction or control as to the manner in which services are provided" means.

How does SDC work in practice?

Reading HMRC's guidance would lead contractors to believe that something as simple as taking a brief puts a contractor inside SDC. But this is not how SDC actually works in practice.

"Does providing a brand guide for a marketing contractor to use when working on a client's project mean SDC applies? In practice no, because if the client wants work produced in a particular manner – such as specifying the tone of voice of marketing copy - but is not giving detailed instruction as to how the contractor goes about writing the actual copy that adopts the required tone of voice, then SDC is not present."

"Once you are in the realms of engaging experts or highly skilled professionals, then it should not be necessary to stipulate how work is done. Yes, provide the contractor with specifications and guidelines but then leave it to the expert to decide how they go about achieving what end the client wants."

Staples v Secretary of State for Social Services

It is well established by a key agency legislation case from the eighties, [Staples v Secretary of State for Social Services 1985](#), that a client is not exerting SDC simply by giving a brief to a contractor.

"In this case, the owners of a restaurant drafted in a temporary head chef. Although the restaurant owners had the right to decide what the menus were, the head chef had a degree of discretion over how they were delivered.

"The court decided that the measure of discretion that the head chef had was such that he was not subject to direction from the management on how to do the job. Management could set the menus but it was determined that this was irrelevant in terms of how the job should be done. The same principle applies to taking a client brief."

Vessey stresses that genuine contractors are unlikely to fail the SDC test, particularly as recent Tax Tribunal rulings have strengthened some of the interpretation and not in the taxman's favour: "The control test has been amplified within the SDC framework, and HMRC has its own view on interpretation.

"However, control has been determined and shared by case law, either in an employment or tax context – you only have to look at what the tribunal judges said in the IR35 cases such as Marlen, [Primary Path](#) and [ECR Consulting](#). The lack of control over how the contractor did their work was key. HMRC cannot simply decide to change or ignore these rulings, although Tax Tribunal decisions do not normally set binding legal precedence."

Contractors should adopt 'SDC best practice'

Vessey's words underline how important it is for contractors to adopt 'SDC best practice', and secure expert advice if challenged by HMRC over SDC: "Contractors can apply the same principles to staying 'outside SDC' as they do for staying 'outside IR35' – in fact it should be more straightforward as the contractor only needs to look at one aspect of control."

Vessey advises contractors seeking to stay outside of SDC to:

Ensure that there is no mention of SDC in the contract. Vessey notes that in reality, HMRC will look at what happens in practice, but it is important that reality and the contract are consistent

Secure a [confirmation of arrangements](#) signed by the client and contractor that confirms the day-to-day working arrangements, just like with IR35. This should confirm that the features associated with SDC are not present in the relationship

Keep an SDC file for each contract. In practice, this will include the same emails, meeting notes and telephone conversation notes as an IR35 file. This could include vital proof, in the form of briefing emails/documents from clients that could halt an HMRC investigation before it even gets started

Take out [tax investigation insurance](#). Vessey highlights: "An inquiry under the proposed withdrawal of travel and subsistence expenses is in fact a PAYE matter, so a comprehensive tax investigation insurance policy that includes PAYE enquiries and investigations will cover SDC, although contractors should check their insurance paperwork."

HMRC plans to use SDC for IR35 and to determine eligibility for expenses tax relief

Vessey highlights that the subject of control has always remained at the forefront of IR35 so contractors will be aware of what it entails. However, the microscopic view of the 'how' aspect, in the form of SDC, may be something that contractors are not particularly used to.

That is until HMRC proposed using SDC to determine whether contractors are eligible for expenses tax relief in its recent consultation over travel and expenses tax relief and as a possible replacement to existing IR35 tests as suggested in HMRC's discussion document.

"Control and personal service are already very much the focus of IR35 inquiries, and this would not be new if IR35 was changed," believes Vessey. "But, based on the expenses consultation wording, what will be new is the way that HMRC perceives it and just a hint or a sniff of SDC will be enough for an inspector."

Vessey concludes: "This does not change the underlying legislation and case law which does require HMRC to follow process.



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Andy is a Senior Tax professional at Qdos and has a wealth of experience in IR35 and status matters which he guides the firm on.

Qdos Consulting is a leading expert in status and IR35. The company also consults in taxation and employment law and provides low cost business insurance for contractors. [Read Full Profile...](#)

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"My concern is that HMRC is trying to boil down control to a more simplistic view and then try to scare contractors, using 'new' legislation as a deterrent. As a result, contractors may not claim expenses they are entitled to, or may believe themselves to be inside IR35 incorrectly."

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