

What is an IR35 Status Determination Statement (SDS)?



Draft amendments to the IR35 legislation introduced within the Finance Bill 2020 require that clients provide an IR35 'status determination statement' when assessing the IR35 status of contractors, before a contract begins. A 'Status Determination Statement' (SDS) is a comprehensive statement from the client which:

- Declares a contractor's deemed employment status following an IR35 assessment
- Provides reasons for reaching this conclusion.

This new legislative requirement is intended to help combat misclassification of status due to non-compliant blanket or role-based assessments. Crucially, the draft amendments clarify that the requirement for an SDS is not met if the client fails to take 'reasonable care' in arriving at its decision. Should this be the case, the client assumes the position of 'fee-payer' which would typically be held by a recruitment agency.

As the fee-payer, the client assumes liability for any tax deemed unpaid as a result of the engagement. They also assume responsibility for reporting and deducting tax from payments made to contractors. Consequently, for hiring organisations, providing a valid and accurate status determination statement is essential to meet their statutory obligations and mitigate any financial risk.

What does reasonable care mean?

Though the draft legislation fails to explain what 'reasonable care' means, an examination of HMRC's own practices and the case law offers some clarity. This suggests that even a minor misdemeanour can fall foul of the requirement. Philip Manley, former HMRC inspector and current director of PMTC Ltd, explains:

"Every year, HMRC enquires into thousands of tax returns completed by UK taxpayers. If there is an error leading to a loss of tax, HMRC will often apply a tax-geared penalty for failure to take reasonable care."

Manley notes that a penalty will apply in one of three circumstances where the outcome is a loss of tax:

1. Where the taxpayer makes a careless error (in providing information to HMRC)
2. When a third-party supplies information that is false or deliberately withholds information

3. When a taxpayer fails to notify HMRC that an assessment is too low.

“Reasonable care is a tightrope,” says Manley. “Though there is no official guidance on how it applies to clients with regards to IR35 status determinations, it’s clear that HMRC is not averse to using the argument when it believes tax to be due.”

HMRC’s [Compliance Handbook](#) also offers some clues as to its approach to reasonable care by providing numerous examples of what is considered ‘careless’ and therefore punishable.

What constitutes reasonable care?

Being a necessary component of an SDS, it’s important to be able to determine what does, and does not, constitute reasonable care when conducting status assessments.

Due to the ambiguity over the reasonable care requirement in the legislation governing Off-Payroll in the public sector (Chapter 10 ITEPA), blanket assessments have become commonplace amongst public sector hirers, typically falling into one of two categories:

1. Where a client makes an IR35 status decision without conducting an assessment
2. Where a client assesses a role and applies the status determination to a number of contractors.

However, [employment status lawyers have noted](#) that, in the context of a contractor facing an inquiry, reasonable care would constitute:

1. Acquiring independent legal advice; and
2. Making a full assessment on an individual basis.

Though applied to a different context, this would mean that clients conducting blanket status assessments would have failed to have taken reasonable care, on the basis that they failed to assess contractors individually.

This is required in order to consider important factors unique to the contractor which can’t be deciphered from the contract, such as whether they are in business on their own account (IBOYOA). As a result, failure to assess contractors on an individual basis would render any subsequent SDS invalid.

What are the consequences of failing to take reasonable care?

Failure to take reasonable care has significant consequences for clients. Under the Off-Payroll legislation, failing to take reasonable care renders the hiring organisation:

- Responsible for deducting tax from the contractor’s income if deemed ‘inside IR35’;
- Liable for employer’s National Insurance (NI) and the Apprenticeship Levy; and
- Liable for any outstanding tax if HMRC successfully challenges a status decision.

There are further potential repercussions. As Manley explains, the same logic from HMRC’s Compliance Handbook could easily be applied to any client responsible for conducting a status assessment and providing an SDS:

“If HMRC investigates because it suspects that reasonable care has not been taken, it may argue that the client has been ‘careless’ in making its assessment. HMRC then has the right to extend its enquiry window from four to a full six years, increasing the tax risk even further.”

The tax liability, coupled with the possibility that HMRC enquiries could stretch as far as six years, imposes a huge financial risk on clients – reinforcing the importance of due diligence.

Successfully defending a blanket or role-based assessment in court would prove a tall order, as HMRC could quite easily demonstrate that not enough detail was looked at. Ultimately, the only way to guarantee meeting the reasonable care requirement is to assess each individual on a case-by-case basis.

A comprehensive status determination is also necessary to mitigate the threat of the potential breakdown of an engagement. If it is clear to the contractor that an assessment has only considered the contract or role in question, they will likely be encouraged to challenge the assessment and potentially litigate. It's essential that all parties agree the status determination up-front before the work starts.

Clients are advised not to base a status determination on HMRC's Check Employment Status for Tax (CEST) tool as it omits key areas of law and is unable to provide reasons for having reached a status decision. It could also be argued that a client using CEST wouldn't be deemed to have been "exercising reasonable diligence", an essential requirement of reasonable care as specified in Anderson (deceased) (TC206).

How clients can use IR35 Shield to create Status Determination Statements

The main deterrent from complying for clients is the perceived workload involved with taking reasonable care in conducting a status assessment. To negate this, some private sector firms have imposed blanket bans on engaging limited company contractors.

Though such a move which will inevitably impact projects by restricting access to key skills, the legislative requirement for clients to provide each contractor with an SDS threatens to encourage others down a similar path. However, there is a solution through which clients can fulfil their compliance requirements, without incurring significant administrative costs or time.

[IR35 Shield](#) is an AI-powered, outsourced SaaS solution available to hiring organisations. Companies can use IR35 Shield's Collaborative Assessments capabilities to pre-answer some questions on the assessment, ensuring accuracy, before inviting contractors to answer the remainder of the questionnaire.

Between them, contractor and client complete a comprehensive assessment of over 100 questions, spanning the full factual matrix of employment status factors required to demonstrate reasonable care has been taken. This is roughly the same amount of questions that HMRC inspectors will ask when conducting an IR35 investigation, and significantly more than the 16 questions currently posed by CEST.

After the final question has been answered, an immediate status determination is made, and a 25-page Status Determination Document is generated, comprehensively detailing the reasons for the final determination while demonstrating reasonable care in the process.

IR35 Shield is also designed to mitigate the risk of disputes. Should parties disagree over questionnaire answers, IR35 Shield can be used to determine whether the answers in question make a material difference to the assessment outcome. If they do, then clients can make a judgment on them and decide whether to issue a re-assessment. Otherwise the assessment status is the same, and the resolution process is complete.

To experience how your company can issue compliant Status Determination Statements without the administrative burden, [request an IR35 Shield demo](#) online today.

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