Chain, Chain, Chain (of Supply): Due Diligence of Labour Supply Chains

Tax voice

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Sarah Hewson examines end client due diligence on labour supply chains

The extension of the IR35 rules to the private sector with effect from 6 April 2021 has highlighted the need to undertake due diligence on labour supply chains. This has been emphasised by HMRC's increased focus on umbrella company arrangements (broadly, the legal employer of a worker providing their services to a client of the umbrella company), in particular arrangements which it believes have been used to facilitate fraud and tax evasion. Whilst the vast majority of organisations availing themselves of the services of workers (referred to as end users) are not willing participators in fraudulent arrangements, the risk of being so involved is increased where sufficient and robust processes are not in place.

Outside of the IR35 rules, the interaction between labour supply chains and tax legislation is getting increasingly complex with, for example, the introduction and amendment of rules around agency/ temporary workers, the evolution of gig workers and an increase in cross-border working.

Understanding and auditing supply chains as a whole has been growing in importance, as demonstrated by the introduction of the corporate criminal offences (CCO) of failing to prevent the criminal facilitation of UK and foreign tax evasion (Sections 44 and 45 of the Criminal Finances Act 2017) effective from 30 September 2017, which requires businesses to assess the CCO risk in supply chain relationships.

While there are many good reasons why businesses should have policies and processes in place to understand and document labour supply chains, given the reputational, contractor relationship and financial risks associated with non-compliance to end users (and potentially other parties in the supply chain), this is particularly crucial when considering potential obligations under the IR35 rules.

As a first step organisations should take steps to understand and document every party in the supply chain between the end user and the individual worker, the type or nature of each entity (for example, a company, partnership, individual) and where that entity is based/resident (in particular whether this is inside or outside the UK).

HMRC has published guidance on supply chain due diligence in respect of labour supply chains (see https://www.gov.uk/government/publications/use-of-labour-providers), which includes an overview of the basic supply chain due diligence principles (check, act and review), with some pointers on how these might be applied in a labour supply context. A key part of HMRC's guidance is verifying the legitimacy of entities in the supply chain by considering, for example, the commerciality and credibility of the supply, payment arrangements and other surrounding circumstances.

Though HMRC's suggestions are helpful, some information is easier to gather than others. This problem is exacerbated where one or more entities are not resident in the UK where the same level of information as that for UK companies (for example, via Companies House) is not always as freely available. This is further complicated when it comes to undertaking checks in relation to individual workers. For example, whilst reviewing payslips may have some merit, leaving aside whether the end user has any ability to request sight of such a confidential document in the first place and any potential GDPR issues, any payslip presented does not necessarily reflect what tax or National Insurance has actually been withheld from the worker and/or remitted to HMRC. Even if it does, this is merely a snapshot of that particular pay period and does not necessarily demonstrate the ongoing position. HMRC's suggestion that the PAYE reference quoted is reconciled back to the employing entity is not entirely helpful given that such references are not published/publicly available, such that it is difficult to independently verify this.

Despite the difficulties with putting HMRC's guidelines into practice, end users do need to take steps to understand any risk within the labour supply chain. Which checks are relevant and how often they should be undertaken will depend on a number of factors, including what is reasonable and proportionate for the business given the number and value of payments made to off payroll workers that are not directly engaged by the business.

Some checks will be relevant for all arrangements (such as those outlined above) but given the time-consuming nature of many of the checks suggested by HMRC,

businesses could consider implementing a multiple layered process with certain checks being undertaken for all entities, with further checks being undertaken for more complex/higher risk supply chains (for example those where one or more entity in the chain is outside the UK).

Whatever approach businesses take, it is crucial that an approach is devised and implemented to best enable businesses to understand the supply chain, identify any potential obligations for the business and ensure those obligations are met. Given the ever increasing complexity and evolution in this area, any process devised should be regularly reviewed and refreshed where appropriate.

Useful Links

Check how to reduce your risk of using an umbrella company who operates a tax avoidance scheme - GOV.UK (www.gov.uk)

Supply chain due diligence principles - GOV.UK (www.gov.uk)

Call for Evidence: umbrella company market - GOV.UK (www.gov.uk)

Working through an umbrella company - GOV.UK (www.gov.uk)