Tackling non-compliance in the umbrella company market

Employment Tax



18 September 2023

The CIOT and LITRG have responded to a recent consultation on umbrella companies which contained proposals to regulate them and sought views on options to tackle tax non-compliance which is causing harm to workers, compliant businesses and the Exchequer.

CIOT response

The CIOT's comments were mainly limited to the proposals in respect of tax compliance (Chapters 4 and 5 of the consultation document), although we also made some observations in respect of regulating umbrella companies (Chapter 3).

Overall, we agreed that the aim of the consultation should be to deliver improved outcomes for workers, to support a level playing field in the umbrella company market, and to protect taxpayers from the significant revenue losses that currently arise from non-compliance. This said, we recommended that any measures that may

be introduced to achieve these aims should be focused and proportionate.

With regard to the tax proposals, these are:

- Option 1: Mandating due diligence;
- Option 2: Transfer of tax debt that cannot be collected from an umbrella company to another party in the supply chain; and
- Option 3: Deeming the employment business which supplies the worker to the end client to be the employer for tax purposes where the worker is employed by an umbrella company, moving the responsibility to operate PAYE.

In addition, the consultation proposes targeted changes to tax legislation to address the abuse of specific tax reliefs by some umbrella companies. These reliefs are the employment allowance and the VAT flat rate scheme.

We commented that first and foremost those facilitating non-compliance and fraud should be pursued by HMRC for taxes not correctly accounted for, including the owners and providers of the umbrella companies, rather than the worker or another party in the supply chain. We also thought that HMRC could do more to monitor umbrella company compliance, such as requiring the employment allowance to be claimed, rather than effectively being given automatically.

We considered that both Options 1 and 2 could place considerable administrative burdens on businesses. (Under Option 2 a business would effectively be required to conduct due diligence to manage the transfer of tax debt risk.) Hence, if either option is progressed, the due diligence requirements would need to be reasonable, proportionate and clear (and businesses should not be penalised if things inadvertently go awry). There would also need to be an appealable defence that the relevant party took reasonable care, plus mitigation for actions subsequently taken to address the failures, so that any penalties are fair and proportionate. In respect of Option 2, the bar would need to be set at a reasonable level before there is any transfer of tax debt away from an umbrella company.

With regard to Option 3, we commented that the responsibility to account for PAYE/NICs should, in the first instance, rest with the legal employer and not a third party. However, if this option is taken forward, we felt that the deemed employer should be the employment business closest to the umbrella company (as is the case under the off-payroll working rules) rather than the employment business closest to the end client (as applies under the agency workers legislation).

Our alternative proposal was for HMRC to instead maintain a list of registered umbrella companies who satisfy designated requirements around tax compliance, such that employment businesses and end clients can check that the umbrella company they propose engaging is on this list. This approach has worked in respect of the Construction Industry Scheme's gross payment status requirements to mitigate tax lost and drive up compliance and we felt could be applied to this sector too.

LITRG's response

LITRG have had longstanding and serious concerns about umbrella companies and, in particular, disguised remuneration. In 2021, when we wrote our report on umbrella companies, it was clear from our research that agencies are partly culpable for some of the issues. Currently, it seems that while they often outsource their HR/payroll function to umbrella companies, there is very little incentive for them to be concerned about what happens beyond that.

With the tax proposals in the consultation, HMRC are seeking to change incentives and behaviours throughout the entire supply chain, rather than continuing to allow all the risk to fall on workers and the Exchequer. LITRG very much welcome that HMRC are thinking more holistically about the issues and possible solutions.

LITRG's response focused on tax Option 1 (mandatory due diligence) and Option 2 (debt transfer). While allowing good umbrella companies to subsist, these would significantly reduce the chances of non-compliant umbrella companies entering labour supply chains in the first place, protecting workers from getting caught up in disguised remuneration. LITRG stressed that HMRC will need to *use*, and *be seen to use*, any new powers in order for them to have the desired effect. We used our response to highlight some practical implications of the options which we hope will help HMRC to shape the best, most workable, policy proposals possible.

We said we did not think Option 3 (deeming the agency to be the employer for tax purposes) was viable, as one of the likely reactions will be that agencies simply stop using umbrella companies. It occurs to us that if agencies start using unencumbered in-house PAYE for workers, the very same issues that arise with umbrella companies

and distortive behaviour could simply shift to agency payroll.

With regards to regulation, we urged the authorities to think creatively and ambitiously, rather than simply trying to make umbrella companies fit within the existing architecture. Tweaking the existing Conduct of Employment Agencies and Employment Businesses Regulations 2003 (more commonly referred to as the Conduct Regulations) will, in our view, be too weak a response. Many of the regulations are irrelevant to umbrella companies, while those that could be relevant do not offer full coverage in terms of the nature and extent of the issues faced by umbrella company workers. Any new regulations would presumably have to fit the existing format and vocabulary, which seems restrictive.

We also highlight that if Key Information Documents (KIDs) were fulfilling the role that was intended, the need for regulation becomes slightly less urgent, and so could allow time to research and design the most effective and efficient framework. For example, the KID should easily respond to several of the issues that have been highlighted in relation to umbrella companies: a lack of transparency over pay rates; and confusion over who the legal employer is. Yet many workers do not receive KIDs and even where they do, we have seen some very poor KIDs, with lots of 'example' information and non-indicative round sum numbers used by default. To this end, we said the Employment Agency Standards Inspectorate need to take a much stronger approach to enforcing KIDs.

The CIOT's response can be found at: www.tax.org.uk/ref1151

LITRG's response can be found at: www.litrg.org.uk/ref2792

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