

**Calculating holiday entitlement for part-year and irregular hours workers
Consultation from Department for Business, Energy & Industrial Strategy (BEIS)
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 We are responding to this consultation on holiday entitlement for part-year and irregular hours workers as tax specialists with significant insight into the pay and tax issues of the low-paid.
- 1.2 We have a particular interest in agency workers that work through umbrella companies. These are often irregular hours workers. We know from our work, and from other research that has been conducted in this area, that not all umbrella companies are compliant with their legal obligations and that some workers miss out on their holiday entitlement.¹
- 1.3 Although we are not employment law experts and the terminology in the consultation document is not always completely clear (see 4.5 below), we are pleased the government is considering the impact of both the Harper Trust v Brazel judgement and these proposals on umbrella company workers. In this context, we offer some broad comments in our response.
- 1.4 The 12.07% method of calculation, where holiday entitlement accrues at a rate of 12.07% of hours worked, and referred to as the ‘percentage method’ in the Brazel judgment is often used by compliant umbrella companies to calculate holiday entitlement for their workers. However several years ago, in response to the progression of the Harper Trust v Brazel case through the courts, (hereafter called ‘Brazel’), ACAS stopped promoting the 12.07% method for all those who work irregular hours, in case it produced an underpayment that could be challenged in line with the emerging Brazel principles.

¹ In Rebecca Seeley Harris’s 2021 paper ‘Umbrella Companies - Call for Regulation’, it is said: ‘First, consider holiday pay. Using a sector turnover figure of £30 billion, 12.07 per cent should be paid as holiday pay. It is estimated that 70 per cent is not paid, equivalent to £2.5 billion. Non-payment is via: not informing workers they are entitled to holiday pay; not warning workers they will lose their entitlement to holiday pay if not taken by the end of the year; not allowing workers to carry it forward between holiday years (which is unethical but legal); underpaying; making calculations too difficult to follow; and failing to pay accruals with the P45.’

- 1.5 The UK Supreme Court² has now confirmed that the percentage method **is** incorrect for part-year workers on permanent contracts. The result is that part-year workers are now entitled to a larger holiday entitlement than part-time workers who work the same total number of hours across the year, which is seen by some as unfair.³ The Court offered no comments on whether the 12.07% method could fit in other contexts.
- 1.6 It should be noted that only some umbrella company workers are part-year workers (despite the ubiquitous overarching contracts), and for these workers, there are, of course, questions over how any additional holiday entitlements that surface as a result of Brazel, will be funded by compliant umbrella companies (or indeed, avoided by non-compliant umbrellas).
- 1.7 Our analysis shows that the 12.07% calculation should still provide more or less the correct result⁴ for most umbrella company workers, despite it having no legal basis. However the withdrawal of official guidance on the 12.07% method and the subsequent Brazel judgment has caused confusion, uncertainty and even some scare mongering about potential costs to umbrella company employers. This is never a good combination when it comes to the umbrella company sector, where there is already a lack of transparency and where distortive behaviour is commonplace.
- 1.8 We welcome the government's proposal set out on page 16 of the consultation to essentially reverse Brazel and ensure that holiday entitlement received by part-year workers is proportionate to the time they spend working - given that the proposal also results in the percentage method being put on a statutory footing for **all** types of irregular hours workers.
- 1.9 Irregular hours workers will benefit from having improved clarity on their holiday entitlement, allowing them to better identify when they are not receiving their full entitlement. Employers will also benefit from the greater clarity in legislation, which will help avoid accidental non-compliance. This should help umbrella company workers, as well as other irregular hours workers, such as those on zero hours contracts, receive the paid holiday they are entitled to. As holiday pay is taxable as normal income, this in turn will help raise Exchequer receipts.
- 1.10 However we also urge the government to consider their position on rolled up holiday pay as this could further improve outcomes for workers.
- 1.11 The government should move forward with proposals to enable state enforcement of holiday pay as soon as possible. Given the Single Enforcement Body (SEB) seems to have been put on hold, we wonder whether the idea that HM Revenue & Customs (HMRC) should undertake this role will be resurrected. We have vast experience of working with HMRC and suggest a consultation to seek views on whether HMRC is the most appropriate body for this, would be a good starting point.

² <https://www.supremecourt.uk/cases/uksc-2019-0209.html>

³ An example is where an exam invigilator works one week a year @£100. If they remain employed for the remainder of the year, they would essentially be entitled to 5.6 weeks of holiday @ £560.

⁴ That is, the same result as the strict method set out in Brazel.

- 1.12 We are happy to discuss any aspect of our response in more detail and are available to input on draft legislation, guidance for employers (including, hopefully, tailored guidance for the umbrella sector covering things like requirements for communicating about holiday entitlement following the Smith v Pimlico Plumbers case) or any other implementation aspects, if that would be helpful.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

- 3.1 We are not employment law specialists but have an expertise in the pay and tax issues of the low paid. As such, we have previously responded to the Good Work consultation on 'Enforcing Employment rights'⁵ (which sought views on Matthew Taylor's recommendation for HMRC to enforce a wider range of basic employment rights including holiday pay) and to the Good Work plan⁶: establishing a new single enforcement body for employment rights (which included enforcing holiday pay).
- 3.2 We have a particular interest in umbrella company workers, given the specific problems that they can face with their pay and taxes. In March 2021, LITRG released a research report entitled 'Labour

⁵ <https://www.litrg.org.uk/latest-news/submissions/180516-enforcement-employment-rights-recommendations>

⁶ <https://www.litrg.org.uk/latest-news/submissions/191002-good-work-plan-establishing-new-single-enforcement-body-employment>

Market Intermediaries: a technical report outlining how umbrella companies and other intermediaries operate in the labour market and the implications for workers who use them'.⁷

- 3.3 Umbrella companies do not generate income like other commercial businesses. Instead, an amount to fund holiday pay for their employees is taken from the agreed assignment rate (the money sent to them by the agency or end client) and then, at some point, is paid out to the worker as holiday pay (so it is basically a reallocation of funds). From our report, as well as from the growing body of other work in this area, we know there are already serious problems with holiday pay affecting umbrella company workers, including umbrella companies withholding the money that should fund holiday pay.⁸
- 3.4 In an industry often marred by misinformation, unethical behaviour and opaque employer practices, we are concerned that the Brazel judgment and the potential confusion stemming from it, could make things worse. We are therefore concerned that without intervention, the status quo is going to result in more umbrella company workers ultimately missing out on their holiday entitlement.
- 3.5 We welcome any steps that bring clarity, certainty and consistency to the labour market and improves the positions of low paid workers (umbrella company or otherwise). We are therefore pleased to see swift action from the government following the Supreme Court judgment⁹ which includes a comprehensive impact assessment.¹⁰
- 3.6 We have focussed on the specific questions 21 and 22 on agency workers and umbrellas, however some of our more general comments may be useful as input for questions 17, 18 and 19.

4 General comments

- 4.1 Although it has no statutory basis, until recently, it has been widely accepted that using a formula of 12.07% to calculate holiday entitlement for staff without regular working hours was a simple and effective 'rule of thumb'. This was also the approach originally suggested by the ACAS guidance and the GOV.UK online holiday calculator.

⁷ <https://www.litrg.org.uk/sites/default/files/files/LITRG-Labour-Market-Intermediaries-Report-2021.pdf>

⁸ One of the issues alluded to in our report was around umbrella companies withholding money where the umbrella workers did not seem to understand the circumstances in which they might lose their holiday pay (for example, if they did not request it before the end of the holiday year). A real life example of an umbrella withholding holiday pay was subsequently covered in a high profile BBC Moneybox story: <https://www.bbc.co.uk/programmes/m000tcl7>

⁹ We assume this is the reason the consultation is only open to responses for eight weeks.

¹⁰ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/112836/7/holiday-entitlement-consultation-stage-ia.pdf

- 4.2 The Employment Appeal Tribunal's (EAT) decision in 2018 in *Brazel*, cast doubt on the practice of using 12.07%. New, lengthy and complex guidelines set out a different approach based on the emerging principles from *Brazel*.¹¹ Yet in the absence of any realistic, practical alternative to these cumbersome and administratively demanding guidelines,¹² many employers continued to use the 12.07% method. To be clear – if staff do work every week (other than annual leave), the 12.07% calculation will, in many cases, give an answer that is broadly in line with *Brazel* (the 'Calendar Week Method'). However questions remain over whether employers who continue to use the 12.07% method are fulfilling their obligations properly, so the situation is less than ideal.
- 4.3 The UK Supreme Court has recently confirmed in *Brazel*, that 12.07% holiday entitlement calculation method is incorrect for part-year workers on permanent contracts. In this case, by using the 12.07% method, the Harper Trust pro-rated *Brazel*'s holiday entitlement both on the basis that she was part time (zero hours), but also on the basis that she only worked part of the year (term time). This resulted in less holiday pay than the alternative basis, which took into account her average earnings (and therefore that she was part-time), but not that she only worked part year. The result of the judgement for *Brazel* is that part-year workers are now entitled to a larger holiday entitlement than part-time workers who work the same total number of hours across the year.
- 4.4 The *Brazel* ruling has unwelcome financial implications for employers of part-year workers at a time when they may already be grappling with increasing costs and difficult trading conditions. The employer reaction and implications of the judgement on the employment opportunities of workers are as yet, unknown. But it also leaves employers who need to calculate holiday entitlement for wider groups of workers with irregular hours, with a lack of clarity and a feeling of risk that the percentage method is open to challenge.
- 4.5 While the language in the consultation document is not clear (the document refers to agency workers as those with 'contracts for service' but also refers to those arrangements being operated by umbrella companies – who usually employ agency workers under a contract of service¹³), we *assume* that the consultation is seeking to understand the implications of the judgment on different sectors including agency workers who work through umbrella companies (who have an overarching

¹¹ <https://www.gov.uk/government/publications/calculating-holiday-pay-for-workers-without-fixed-hours-or-pay/calculating-holiday-pay-for-workers-without-fixed-hours-or-pay--2> and <https://www.gov.uk/government/publications/calculating-holiday-pay-for-workers-without-fixed-hours-or-pay>

¹² The situation is basically that workers are entitled to:

- The full statutory minimum of 5.6 weeks (28 days) paid holiday entitlement per year. This entitlement is not reduced on a pro-rata basis if they work part of each year of employment; and
- Their pay for this holiday must be based on the "Calendar Week Method" of averaging a week's pay. This means that the individual's pay over the previous 52 week period must be averaged to calculate the entitlement to holiday pay. Only the weeks actually worked will be considered for the calculation

¹³ See for example, on page 22 – 'Agency workers may have a contract for services with an umbrella company, which employs agency workers with a view to them being supplied to work for and under the control of an end client.'

contract and thus, a continuity of contract between assignments). We would welcome clarification but in the meantime, we think that we can provide valuable insight here due to our extensive work in the area of agency workers and umbrella companies.

- 4.6 It is worth saying that we cannot see that the Brazel judgment will have an impact on agency workers who do not have an overarching contract with an umbrella company, and who work on an assignment-by-assignment basis with no continuity in between, as they would not be part-year workers.
- 4.7 Some commentators have highlighted the ‘significant impact’ that this ruling will have on umbrella company workers.¹⁴ We have seen comments about ‘potential huge financial implications’ for people employed by umbrellas, that workers may be entitled to back-dated holiday pay, that umbrella companies face ‘legal claims’ and that umbrella companies may ‘go bust’. This is unhelpful as it may cause umbrellas to act in certain ways to protect their profitability from perceived harm.
- 4.8 Our own analysis shows that the ruling should only affect umbrella workers where there are unpredictable periods when a worker will neither be working, nor on paid leave, but where the employment relationship nevertheless continues. The question is, as a matter of economic reality, how many low paid agency workers are going to be with an umbrella but out of assignment for very long? Our 2021 report showed that (for various reasons) this was fairly unlikely, except for specific cases like supply teachers etc. where there are often non-worked weeks.
- 4.9 If the reality is that most umbrella workers are not really ‘Brazel’ type part-year workers at all, but full year workers who just have variable hours each week (or given the churn with assignments/umbrellas, indeed are joiners or leavers), then we think the percentage method produces a satisfactory result.
- 4.10 In a recent update to our factsheet for umbrella company workers¹⁵, on page 3 we explain the impact of the Brazel case on umbrella company workers, which we think correctly reflects the position:
- 4.11 *Full-time workers have the right to a minimum of 28 days’ paid leave including bank holidays (although you could be entitled to more under the Agency Workers Regulations, as explained previously). If you work irregular hours, under a typical umbrella company contract, it used to be the case that your holiday entitlement would probably be calculated as a percentage of hours/earnings. 28 days paid leave (or 5.6 weeks) is equivalent to 12.07%, assuming a working year of 46.4 weeks (i.e. 52 weeks minus the 5.6 weeks). Some umbrella companies have an education specific percentage of 14.36% as there is a shorter (39 week) working year.*

¹⁴ For example see here: <https://twitter.com/paullewismoney/status/1549700507857551361>

¹⁵ https://www.litr.org.uk/sites/default/files/LITRG-factsheet-working-through-an-umbrella-company-2022_0.pdf

Example: Mary works 17 hours one week, 20 hours the next week, and then 15 hours for next two weeks. After nearly a month of working, she has built up entitlement to approximately 8 hours of paid leave (67 hours x 12.07%). If she usually earned £10 an hour, she would be entitled to £80 (holiday pay is calculated based on your average pay rate in the preceding 52 weeks in which some work is done, including bonuses, overtime, commission where relevant).

This was a simple system but meant that Mary would not build up holiday in weeks when she was employed but had no work. Following a recent Supreme Court ruling, Mary will be entitled to 28 days leave a year, regardless of whether she has work in a particular week or not. If she is expected to work most weeks, albeit with irregular hours, she may find that her umbrella company continues to use the 12.07% calculation, as this should produce more or less the correct result. If she is expected to have significant unworked weeks (for example if she has gaps between assignments or is in a role where she is only required to work part of a year), she may find that her umbrella company gives her a type of contract that doesn't continue over unworked weeks or they may use an alternative to the 12.07% figure in their calculations.

4.12 In this consultation, the government proposes that statutory annual leave entitlement for part-year workers and workers with irregular hours should be calculated by employers using the following two steps:

- Calculate the total hours a worker has worked in the previous 52 weeks (the reference period), including those weeks without work;
- Multiply the total hours worked by 12.07% to give the worker's total annual statutory holiday entitlement in hours.

4.13 As well as dealing with the disparity between part year and part-time workers caused by the Brazel case, this would effectively formalise the 12.07% method for irregular hours workers, that many employers already use and workers understand and know well.

4.14 Workers will benefit from having improved clarity on their holiday entitlement, allowing them to know when they are not receiving their full entitlement. Umbrella companies will also benefit from the greater clarity in legislation, which will help them avoid accidental non-compliance.

4.15 This should help workers receive the paid holiday they are entitled to. As an added benefit, holiday pay is taxable as normal income, this in turn will help raise Exchequer receipts.

5 Specific questions

5.1 **Question 21. Would you agree that calculating agency workers' holiday entitlement as 12.07% of their hours worked at the end of each month whilst on assignment would make it easier to calculate their holiday entitlement and holiday pay?**

- **Strongly agree**
- **Agree**
- **Neither agree nor disagree**
- **Disagree**

- **Strongly disagree**
- **Don't know**

Please explain your answer.

- 5.2 Yes, we agree.
- 5.3 As a supplementary measure, we urge the government to also consider their position on rolled up holiday pay.
- 5.4 Some agencies and umbrella companies already offer to include an amount for holiday pay in wages on an ongoing basis - a system known as rolled up holiday pay (this might sometimes be called 'advanced' holiday pay which is very similar). Strictly this is incorrect, as the law says that it should be paid out at the time annual leave is taken (a system known as accrued holiday pay), but many workers prefer the rolled up system and indeed the following recommendation came out of the Matthew Taylor Good Work report¹⁶:
- 'We also believe individuals should have greater choice in the way in which they receive paid annual leave. As a general rule, annual leave entitlement equates to 12.07% of hours worked. We believe individuals should have the choice to be paid for this entitlement in real time - known as 'rolled-up' holiday pay. This would result in dependent contractors receiving a 12.07% premium on their pay...Additional safeguards would have to be built in to ensure individuals did not simply work weeks a year as a result, but we believe giving individuals this kind of choice will suit many working in casual arrangements and in the on-demand economy.'*
- 5.5 If a worker is on an accrued holiday pay system and leaves an agency or umbrella company having taken fewer holidays than they are entitled to, they should be paid in lieu of the untaken holiday – but it is our understanding that this does not always happen. Similar issues arise at the end of the holiday year when untaken holiday can lapse. Whether it is down to a lack of knowledge on the part of workers or potentially vulnerable workers not feeling that they can challenge the agencies or umbrellas, we understand that some engagers in the agency worker arena view untaken holiday pay as an additional revenue stream. Rolled up holiday pay is a simple and well liked system (particularly by those who may feel they cannot afford to take time off at that moment), but also helps workers avoid this underhanded approach taken by some engagers.
- 5.6 Given this area is under review, we recommend the government consider whether to allow rolled up holiday pay in certain circumstances, as this would build on the proposals before us, to significantly improve outcomes for workers.¹⁷

¹⁶ <https://www.gov.uk/government/publications/good-work-the-taylor-review-of-modern-working-practices>

¹⁷ Assuming the government are talking about umbrella company workers who remain employed between assignments, the wording in the consultation suggests something similar to rolled up holiday pay might be possible, where for example, a worker starts a new assignment directly after finishing an assignment in which

5.7 **Question 22. Do you have any further comments about calculating holiday entitlement for agency workers?**

Please explain your answer.

- 5.8 In our experience, the problems that workers face with holiday entitlement, can be rooted in the same ground as the tax issues that we come across – the workers’ own lack of knowledge of their rights, and employers having little fear of being challenged in terms of whatever cost/obligation displacement activity they instigate.
- 5.9 The proposals in this document are a good starting point to ensuring workers get the holiday that they are entitled to. However, this needs to be supported by a more accessible means for low-paid workers to secure payment if things go wrong – something that, in our view, is currently lacking for holiday pay, even with the demise of employment tribunal fees.
- 5.10 Low paid workers need their positions protected and we think that would be best achieved by there being a state body that enforces holiday pay. We urge the government to refocus on proposals to enable state enforcement of holiday pay as soon as possible – starting with a consultation to try and identify the most appropriate organisation for doing so.
- 5.11 Prior to discussions regarding the SEB (which despite extensive commentary, consultations and the government’s public commitment to establishing, we understand has now been put on hold¹⁸), there was a proposal by Matthew Taylor that this could be undertaken by HMRC.
- 5.12 This proposal should be resurrected and considered fully. Some stakeholders with experience and knowledge of HMRC’s existing enforcement function (both from a tax and minimum wage perspective), may question whether it is possible for them to tackle work of this nature without new vision, energy and far greater funding and resources. Additionally, some workers may ‘fear’ HMRC, particularly if they have had problems with them before over tax or tax credits issues. Others will not wish to open themselves up to the scrutiny of HMRC staff, meaning workers may be reluctant to approach them to report problems. A consultation exploring all of these issues would be welcome.

an element of holiday entitlement has built up. It says on page 22 ‘As agency workers have the right to take annual leave whilst on assignment, they could take their accrued annual leave and be paid for it, rather than receiving holiday pay as payment in lieu at the end of their assignment. For shorter assignments, agency workers may prefer to take their annual leave at the end of their assignment or **receive holiday pay in lieu when their assignment comes to an end**’.

¹⁸ In a recent session of the Business Energy and Industrial Strategy (BEIS) Committee, Business Secretary Grant Shapps revealed that the government has no plans to implement such an enforcement body, remarking: “We have spent more than two years of this Parliament fighting Covid-19 ... it may be that with two years left of Parliament, we are still able to address single enforcement bodies ... [but] we are more interested in ensuring that the bodies that are already in place are operating effectively.” See <https://committees.parliament.uk/oralevidence/12457/pdf/>

- 5.13 While we have questions over whether HMRC are, in fact, the right state body to take on the role of enforcing holiday pay, we reiterate that we do wish to see the introduction of state enforcement in order to protect workers. We also wish to see any improvements to the legal framework on holiday entitlement as a result of this consultation, accompanied by improved information, advice and support for employers. This should include comprehensive examples and guidance for employers around the impact of the *Smith v Pimlico Plumbers* case.¹⁹ Employers who want to be compliant with the rules but who currently find holiday entitlement a difficult and complicated area of employment law to navigate, would no doubt welcome this.

LITRG
6 March 2023

¹⁹ See <https://www.bailii.org/ew/cases/EWCA/Civ/2022/70.html>. The Court of Appeal has ruled that a worker can only lose the right to take paid leave within the holiday year when: • The employer can show it specifically and transparently gave the worker the opportunity to take paid annual leave; • The employer encouraged the worker to take paid annual leave; • The employer informed the worker that the right would be lost at the end of the leave year.