

**Tackling non-compliance in the umbrella company market  
Response from the Low Incomes Tax Reform Group (LITRG)**

**1. Executive Summary**

- 1.1. We welcome this consultation which contains proposals for both regulation and options for tackling tax non-compliance in the umbrella company market, which we hope will go a long way towards addressing our longstanding and serious worries about disguised remuneration arrangements in this market.
- 1.2. Disguised remuneration (DR) is an insidious issue. As well as being a problem for HMRC in terms of the tax that is lost, it has a significant impact on the life and well-being of those low-income workers who may find themselves being paid via DR through no fault of their own.
- 1.3. In our view, options one and two set out in chapter 4 of the consultation (relating to tackling tax non-compliance) would significantly reduce the chances of non-compliant umbrella companies entering labour supply chains in the first place. This would also protect workers from getting caught up in DR, while allowing good umbrella companies to subsist. For both options HMRC will need to *use, and be seen to use*, any new powers in order for them to have the desired effect and we take the opportunity in our response to highlight some practical implications of the options which we hope will help HMRC shape the best, most workable, policy proposals possible.
- 1.4. For instance, a tax geared penalty for agencies who do not undertake reasonable due diligence sounds simple but will require HMRC to make the right decision around what reasonable due diligence is and then, where necessary, quantify the umbrella company's liability, which can take substantial amounts of time and resource. Once quantified, some kind of pro-rata apportionment would be necessary to identify any particular agency's portion of the liability, given an umbrella company will typically house hundreds or thousands of workers from a variety of different agencies. It goes without saying that statutory defences would need to be available to agencies on several grounds, including if they do not agree with the calculations. These same considerations would apply for the debt transfer option.
- 1.5. Both leading tax options introduce burdens for HMRC. Given they should both result in the same outcome (agencies taking more responsibility for their supply chains), in many ways the correct policy option of the two might be the one that HMRC feel that they are best able to operate in the

current environment of problematic intermediaries and issues like phoenixing, external pressure and resource constraints.

- 1.6. While regulation of umbrella companies feels like a natural step, we would like the government to think creatively and ambitiously rather than simply trying to make umbrella companies fit within the existing architecture. We highlight that if Key Information Documents (KIDs) were fulfilling the role that was intended and if a new pay calculator were developed allowing workers to ‘follow the money’, the need for regulation becomes slightly less urgent, and so could allow time to research and design the most effective and efficient framework. To this end, we would urge the Employment Agency Standards Inspectorate to take a much stronger approach to enforcing KIDs.
- 1.7. In terms of mini umbrella company abuse of the Flat Rate VAT scheme, we strongly oppose any wholesale changes being made to the Flat Rate VAT regime without wide consultation. Soliciting input in a formal, dedicated consultation containing all relevant facts and supporting data, would allow all stakeholders, including the many VAT experts with specialist knowledge in this field to offer sensible feedback and maybe even offer useful suggestions as to other ways to tackle the mini umbrella company issue from a VAT perspective.
- 1.8. While we are encouraged by this consultation, and in particular HMRC’s tax options, it has taken a long time to get to this point. In our view it is important that once the consultation closes, decisions are made and implemented as soon as possible. In the meantime, we would urge HMRC to consider what more they can do to improve outcomes for workers. For example, we think HMRC could further improve their communications with umbrella workers to reflect the reality that many individuals are involved in DR inadvertently, rather than by choice in an attempt to avoid tax; and rectify the fact that there is no published compliance approach on DR – leading to confusion, fear, and speculation over what might happen when a worker finds themselves in DR.

## **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.

- 2.4. LITRG's work in this area draws heavily on the experiences of TaxAid who assist low-income individuals to comply with their taxation obligations, including around the loan charge and disguised remuneration. TaxAid have inputted into, and endorse, this consultation response.

### 3. Introduction

- 3.1. As we have stated on many occasions, the DR arrangements that LITRG see today are no longer always, or mainly, an issue of traditional tax avoidance. In particular we see that some workers may be paid via DR schemes with little or no understanding at all of the set-up, which is for the umbrella company's own gains (by using DR an umbrella company can carve a higher net pay amount out of a lower gross pay amount and then keep the balance of the assignment rate – savings which are then used to protect profitability or are shared through the supply chain). Despite this, HMRC often seem to want to try and collect DR liabilities directly from workers.<sup>1</sup>
- 3.2. It is not fair or effective for HMRC to continue to try tackling DR in the current manner. For example, focusing on reducing demand by educating workers against the risks of using DR can never really work if workers are not making an active choice to enter DR. Powers intended to reduce supply (for example those focussed on tackling promoters/enablers/suppliers of tax avoidance schemes) are having more impact, however the current suite of tools do not fit intuitively in the umbrella/agency/end client context and are difficult to implement at speed and at scale due to the technical complexity and all the interdependencies.<sup>2</sup>
- 3.3. Something is required to produce a step-change in results and better reflect the principle that situations where the taxpayer is not actively seeking out an advantage and/or does not benefit from being paid through DR differ greatly from those where taxpayers are 'in the market' for a DR scheme.
- 3.4. We therefore very much welcome this consultation, which seeks to tackle non-compliance by changing incentives and behaviours throughout the entire supply chain. The proposals, as well as the specific objectives,<sup>3</sup> show that HMRC are now thinking more holistically about the issues and possible solutions as well as through more of a consumer protection lens. We take the opportunity in our response to highlight some general comments on the practical implications of (what we think

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<sup>1</sup> The PAYE regulations say that in most instances, HMRC should pursue the employer for any underpayment: <https://www.legislation.gov.uk/ukxi/2003/2682/regulation/80>

<sup>2</sup> For example, the enablers legislation arguably does not apply where there is no 'avoidance' per se, and agency workers are simply paid through disguised remuneration and in any case, can only be invoked once the GAAR have opined: <https://www.gov.uk/guidance/tax-avoidance-enablers-of-defeated-tax-avoidance-legislation>

<sup>3</sup> *'The government has three main objectives for the umbrella company market. These are 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.'*

are) the two best tax options which we hope will help HMRC shape the most workable, policy proposals possible.

- 3.5. In addition to DR, we have a number of other concerns with umbrella companies, informed by our work and research and contact from workers, including:
- Workers being given no option by agencies/end-clients but to work through a UC when taking on a temporary role and/or lack of choice of which UC they could use;
  - Lack of pay rate transparency and a perception (largely caused by the lack of transparency) that workers are funding their own employment costs from their entitled pay;
  - Workers not receiving the employment rights to which they were entitled (particularly around holiday) and/or not understanding who is responsible for providing their employment rights across the supply chain;
  - Key Information Documents (KIDs) not being used as intended, with little sign of enforcement activity from the Employment Agency Standards Inspectorate (EAS)). Of note are the statistics set out in the call for evidence response which show that only 50% of workers reported receiving a KID when they were first engaged, which given the potential of the initiative, is very disappointing.<sup>1</sup>
- 3.6. We are therefore also pleased that chapter 3 of the consultation seeks views on the regulation of umbrella companies for employment law purposes. However, as we are not employment law experts, we have limited our responses below to those questions in this chapter where we think we can offer insightful comment. We take a similar approach to chapter 5 given it concentrates on mini umbrella company fraud, which does not primarily impact workers<sup>2</sup> (who are typically our focus).

#### **4. Chapter 3 – Regulating umbrella companies for employment rights**

##### **4.1. Question 3 – Are there any unintended consequences of either option and/or are there alternative ways of defining umbrella companies the government should consider? Please explain your answer,**

- 4.1.1. As we are not legal experts we are not in a position to comment on the most effective way to define umbrella companies. However we note that neither of the options seem to capture arrangements between an umbrella company worker and end client where no employment business is involved. Some ex-PSC contractors (of which there are many, since the off payroll changes caused a shift of contractors into umbrella arrangements), do not need to use agencies to find work, yet can still find themselves caught up with problematic umbrella companies, and so it seems likely they would benefit from being covered by any new regulation too. We do not know if this is intentional or not,

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<sup>1</sup> See para 3.52 to 3.56 –

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1161119/M4027\\_Call\\_for\\_Evidence\\_SoR\\_UCs\\_0103.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1161119/M4027_Call_for_Evidence_SoR_UCs_0103.pdf)

<sup>2</sup> Although it is worth noting that being caught up in a mini umbrella company can cause a worker to have an unusual and fragmented employment record, which can affect them in several ways.

but would welcome clarification and the justification for the exclusion (if indeed that is what is intended).

**4.2. Question 4: What aspects of the umbrella company's role in the supply chain should the regulations cover?**

- 4.2.1. Firstly, it should be noted that the Key Information Document (KID) which should be provided by the employment business to the worker should already deal with several of the issues highlighted in para 3.5 above – for example to bring transparency and clarity in terms of who the legal employer is and the difference between the assignment rate and PAYE rate. We also note at paragraph 2.8 in Chapter 2 of the consultation document that a pay calculator is being explored.<sup>1</sup> If this is intended to be a similar product to what is available commercially (for example, see SafeRec<sup>2</sup>), we think this would be hugely beneficial. It would allow workers to 'follow the money' and give them complete visibility over how the UC is dealing with their pay, including holiday pay. It should allow them to see how much should be deducted from the assignment rate for employment costs to help them spot skimming and it should also provide them with valuable information about how their net pay is calculated that will hopefully help them detect both unlawful and unethical practices.
- 4.2.2. If KIDs were being completed and sent to workers in accordance with the law and a good calculator was developed as a priority, the need for detailed regulation of the UC market becomes, in our view, slightly less urgent. This could ease pressure to allow more time to research and design the most effective and efficient regulatory framework.
- 4.2.3. We think the authorities should be thinking ambitiously about what could be achieved through regulation. Simply tweaking the existing Conduct Regulations (see 4.3.1 below) will, in our view, be too weak a response – many of them are simply irrelevant to umbrella companies, the ones that could be relevant do not offer full coverage in terms of the nature and extent of the issues faced by umbrella company workers and any new ones would presumably have to fit the existing format and vocabulary, which seems restrictive.
- 4.2.4. We would like to see the introduction of regulations that tackle the more structural issues that feed into the problems seen in the market – for example, the fact that it is relatively easy for anyone to set up an umbrella company and that they are typically an asset-light, easily foldable entity – this means there is often very little fear of HMRC in respect of tax abuses or being taken to employment tribunal by workers in respect of pay abuses. The limited liability acts as the ultimate backstop for umbrella companies. Could the regulations introduce a fit and proper test for umbrella company directors for example (creating a barrier to entry for directors who have been disqualified, are not

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<sup>1</sup> 'HMRC is exploring the role a calculator for workers could play in enabling umbrella company employees to work out their gross pay from their assignment rate and the tax that should be deducted from their pay and paid by their employer to HMRC. This may help temporary workers to understand their pay including what they can expect to see deducted, to steer clear of entering into disguised remuneration tax avoidance schemes and to identify and report if their umbrella company appears to be non-compliant.'

<sup>2</sup> <https://payslipbuddy.co.uk/umbrella-company-calculator>

up to date with their own tax affairs or have a history of phoenixing for example) or a minimum liquidity requirement? It is extremely frustrating for workers caught up in DR and those that support them, that apparent evidence of phoenixing can be easily found online, for example by searching via Companies House, yet no-one appears to be able to prevent further Ltd companies being set up.

4.3. **Question 6: Are there reasons that the Employment Agency Standards Inspectorate (EAS) should not enforce umbrella company regulations? And if so, are there other bodies or approaches the government should consider? Please explain your answer.**

- 4.3.1. The EAS is currently a very small body that enforces the Employment Agencies Act 1973 and the Conduct of Employment Agencies and Employment Businesses Regulations 2003 (Conduct Regulations) - although see comment in paragraph 3.5 about the Key Information Document. They have a very specific remit and in 2021/22, the EAS had a budget of just £1.5million.<sup>1</sup> It is therefore hard to see how the EAS could regulate umbrella companies, even on a fairly superficial level, without a wholesale change of approach, substantially increased funding and resources and the right support and expertise in place. We think there need to be some detailed conversations between the departments concerned – and including the Director of Labour Market enforcement – about the desirability/feasibility of the EAS enforcing umbrella company regulations.
- 4.3.2. As we have put forward before,<sup>2</sup> it seems to us that the answer could lie with the Gangmasters and Labour Abuse Authority (GLAA). They are an energetic and dynamic organisation, both matters fit squarely under their remit (they have licensing standards covering basic employment rights including holiday pay and umbrella companies already operate in GLAA licensed sectors) and they are widely regarded as being robust and effective in helping to stamp out bad practices. While we think they have the necessary attitude and experience, they would also need to be given appropriate funding and resources to fulfil this role.
- 4.4. **Question 8: Should EAS mirror its current enforcement approach for employment agencies and employment businesses if it enforces umbrella company requirements? Please explain your answer**
- 4.4.1. We know that agency workers are often vulnerable – they may be young, have limited education or have English as a second language. Even if they are not, for the majority, agency work will not be a matter of choice; rather, it will be something they are forced to turn to if they have not been successful in finding a permanent job or, alternatively, if they wish to gain experience and employability. Bearing in mind these characteristics, it is easy to envisage some workers being afraid

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<sup>1</sup> <https://www.gov.uk/government/publications/employment-agency-standards-eas-inspectorate-annual-report-2021-to-2022/employment-agency-standards-eas-inspectorate-annual-report-2021-to-2022-html-version>

<sup>2</sup> See for example: <https://www.litrg.org.uk/latest-news/submissions/191002-good-work-plan-establishing-new-single-enforcement-body-employment>

of reporting their umbrella company to the authorities for fear of the umbrella company finding out they are the 'whistle-blower'.

- 4.4.2. We also think it is important to acknowledge that workers may have been encouraged to accept the position in the first place by Jobcentre Plus and be concerned about sanctions and a subsequent loss of benefits if they complain or try and leave.<sup>1</sup>
- 4.4.3. In light of the above, we think that there should be at least as much, if not more, focus on proactive work as there is on reactive work when considering the appropriate enforcement approach for umbrella companies, to compensate for low-paid workers' inability or unwillingness to complain

## 5. Chapter 4 – Tackling non-compliance in the contingent labour market

5.1. The consultation contains three strategic options:

- The first of these options is the introduction of a mandatory due diligence requirement, with penalties applying to those employment businesses or end clients that do not comply;
- The second option is to legislate to give HMRC the power to collect an UC tax debt from another business in the labour supply chain, in specified circumstances. This would primarily apply to outstanding amounts of Income Tax and NICs that should have been collected via PAYE.
- The third option would deem the employment business that supplies the worker to the end client to be the employer for tax purposes. This option would require a party further up the labour supply chain to operate PAYE on payments to contingent workers. This would not prevent the deemed employer from using a payroll bureau or UC to discharge their PAYE obligations, but the deemed employer would be ultimately responsible for ensuring the correct operation of PAYE.

5.2. It is worth saying at the outset that we do not believe that option three will improve the picture markedly. We think one of the likely reactions will be that agencies simply stop using umbrella companies. While this responds to some of the concerns raised by workers about not wanting to use an umbrella company, it seems disproportionate and ignores the fact that there are some good umbrella companies who operate PAYE in a compliant manner and have an arguably legitimate role to play in the current labour market. It also occurs to us that if agencies just start using inhouse PAYE for workers, unencumbered, the very same issues that arise with umbrella companies and distortive behaviour could simply shift to agency payroll. We therefore concentrate on options one and two and make a number of general comments in terms of the practical implications, which we hope will be helpful.

5.3. For both options, HMRC will need to *use*, and *be seen to use*, any new powers they get in order for them to have the desired effect. The impact will be lost if the powers simply languish on the statute

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<sup>1</sup> There is some discussion of this in our report (see page 16):

<https://www.litrg.org.uk/sites/default/files/files/LITRG-Labour-Market-Intermediaries-Report-2021.pdf>. While the Decision-makers guidance references tax avoidance and problems with PAYE, we suggest it is very unlikely that Jobcentre Plus staff would be able to put the guidance into practice in reality.

book. This has happened to some degree with the Criminal Finances Act, where the initial fear that was stoked in agencies, and prompted some of them to change their behaviour, has now waned as HMRC haven't really been successfully using it.<sup>1</sup> This means there will therefore be compliance burdens on HMRC - in many ways the correct policy option of the two might be the one that HMRC feel that they are best able to implement and operate.

#### 5.4. ***Option 1 Mandating due diligence – general comments***

- 5.4.1. In 2021 when LITRG wrote our report on umbrella companies,<sup>2</sup> it was clear from our research that agencies are partly culpable for the issues that stem from umbrella companies. Currently it seems that while they often outsource their HR/payroll function to umbrella companies, for a legitimate reason, there is very little incentive for them to be concerned about what happens beyond that.
- 5.4.2. A legal requirement to carry out due diligence will introduce greater consequences for agencies of contracting with non-compliant umbrella companies and so encourage greater visibility of entities in the supply chain. While we welcome this we can see that some agencies might be quite resistant and say that it introduces too much jeopardy.
- 5.4.3. However, some agencies are already undertaking due diligence on umbrella companies they contract with, to assure their supply chains and reduce the reputational and financial risks to them of using an umbrella that is non-compliant. In reality this often takes the form of using umbrella companies that have some kind of 'accreditation', however not all umbrella companies are accredited (often because of the cost), and as we identified in our report on umbrella companies, accreditation does not offer a complete solution<sup>3</sup>. It is foreseeable that this option could result in new accreditation bodies entering the market, increased competition, and/or the accreditation bodies that currently exist, improving their offering.
- 5.4.4. It should therefore be fairly easy for some agencies to adapt existing approaches to ensure compliance with any new due diligence requirements, although we recognise some agencies will need to familiarise themselves with the concept and build in due diligence from scratch. Clear legislation to set out objective factors that HMRC may take into account in determining if due diligence has been done (for example, around the frequency of checks, the existence of risk assessment systems, the requesting of information/evidence, record keeping etc) accompanied by force of law guidance (including examples of what checks might entail in different scenarios – even if not prescribing what they have to do as a minimum) and thorough communications, should help. This should also help HMRC enforcement staff apply the rules and reduce the likelihood of disagreements.

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<sup>1</sup> <https://www.gov.uk/government/publications/number-of-live-corporate-criminal-offences-investigations/number-of-live-corporate-criminal-offences-investigations>

<sup>2</sup> <https://www.litrg.org.uk/latest-news/reports/210324-labour-market-intermediaries>

<sup>3</sup> See Chapter 7 of our report: <https://www.litrg.org.uk/sites/default/files/files/LITRG-Labour-Market-Intermediaries-Report-2021.pdf>



- 5.4.5. We wonder if the Employment Intermediaries reporting form<sup>1</sup> could be adapted to accommodate agencies certifying that they have met the due diligence requirements on any umbrella companies they are using. We also wonder if HMRC can provide any tools (for example a PAYE registration tool similar to HMRC's VAT registration tool) to help agencies understand whether umbrella companies are registered and complying with their PAYE obligations.
- 5.4.6. Due diligence processes are a commercial matter and HMRC will need to consult with experts in this area about what factors/behaviours/actions would be considered as undertaking due diligence as well as how to balance the overriding objective with the administrative burden on businesses that need to do it and HMRC's ability to implement and police it. We wonder, for instance, if the requirement should be for 'reasonable' due diligence, so that expectations will be proportionate to the size of the business? We also wonder what will happen in the event of a dispute between the agency and HMRC as to whether reasonable due diligence has been undertaken. What is the appeal route?
- 5.4.7. At paragraph 4.12 the consultation document says 'The requirement could be supported by a penalty regime, with businesses in scope of the requirement being subject to a penalty if they fail to undertake the required due diligence. A penalty could be set at a fixed amount or linked to the amount of any tax that has not been paid by a non-compliant umbrella company in the culpable business's labour supply chain.'
- 5.4.8. In principle we do not think penalties should be used against one party to collect the tax underpayment of another party. From a practical perspective, we also do not think that a 'tax geared' penalty will work in this context, as they can only be quantified once HMRC have worked the case, which introduces delays, capacity issues and resource implications for HMRC. It should also be remembered that umbrella companies are the employers for many different agencies' workers at any one time. How would HMRC allocate the tax underpayment so as to work out the tax geared penalty for any particular agency? Would the agency or agencies that hadn't done reasonable due diligence be responsible for the entire tax loss across the whole workforce (even if it does not relate to their workers?) or some proportion of it?
- 5.4.9. Fixed penalties are probably simpler and quicker. They are more easily communicated. They are arguably more suited for cases where the behaviour being penalised has an indirect connection with the underpayment of tax. They will need to be set at the right level – if they are too low, they may not be effective in promoting compliance for large agencies – if they are too high, they may simply cause small agencies to fold (with knock on consequences for workers in terms of them potentially not getting paid etc). It is worth noting that a recent report on the size of the agency market suggests that 79.5% of agencies were micro business with fewer than 10 employees, while 82% have less than 1m in turnover.<sup>2</sup>

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<sup>1</sup> <https://www.gov.uk/government/publications/employment-intermediaries-reporting-requirements>

<sup>2</sup> <https://www.rec.uk.com/our-view/news/press-releases/recruitment-industry-contributes-gbp43bn-uk-economy-latest-rec-industry-report>

5.4.10. In any event, we think it is important that there should be a statutory defence available to agencies against the penalties if the umbrella tax loss is because of an innocent payroll oversight or irregularity, because the umbrella failed for genuine business reasons or if they can show that they have taken reasonable care.

5.5. ***Option 2: transfer of tax debt to another party in supply chain – general comments***

5.5.1. As explained in para 5.4.1 above, it seems there is currently little or no risk for agencies when they choose to contract with a non-compliant umbrella company. By creating a potential risk for agencies in the event that the umbrella company does not meet its liabilities, the intention is to incentivise them to pay greater care and attention. We note that the debt transfer option works nicely with the due diligence options and in fact is broadly similar to the due diligence option should the choice be made to levy ‘tax geared penalties’, hence there is some overlap in our comments.

5.5.2. Debt transfer is always controversial and no doubt there will be many comments from a technical and purist perspective. However we note that there are now a number of precedents in the system for HMRC to draw on – the most longstanding of which, the Managed Service Company legislation, is widely regarded as successful at tackling the problem it was designed for. As such we are cautiously optimistic this could be a ‘gamechanger’. As always however, LITRG’s focus is on the practicalities, and from this perspective, we have a number of points to raise.

5.5.3. **What debt will be transferred?** We assume this will be restricted to PAYE tax/NIC debt. However, will it just be debts arising from DR, or any PAYE tax/NIC debt – even, for instance debt relating to a genuine administrative error resulting in an underpayment, where typically Regulation 72 might apply to transfer the debt to the worker?<sup>1</sup> Once you have a baseline figure, the points made in paragraph 5.4.8 about umbrella companies hosting hundreds or thousands of different agencies’ workers at any one time and the need for HMRC to apportion debt to individual agencies, apply.

5.5.4. **What is meant by debt?** Will it only be the debt that is determined through compliance action/a Regulation 80 assessment? This will have implications for HMRC if they have to work each and every case before the provision can be triggered (our experience is that Regulation 80s can sometimes be issued very late in the day and based on estimated information only, which seems less than ideal in this context). Or could it be triggered at an earlier point – for instance in the era of RTI, it may be possible for a failure to be identified at an earlier point (being careful to allow for any short-term payroll/cashflow issues to smooth out). The question is at what point are HMRC going to say that there is an unpaid amount of PAYE tax/NIC and that a debt has been established/confirmed to exist?

5.5.5. **Other monies.** Where DR is used by umbrella companies, other monies can be under deducted/underpaid, as they are based on the minimum wage element of pay only. For example student loan deductions and employee pension deductions. Will these be recovered from the agency and then paid over to the Student Loan Company/the pension provider to help restore the workers position? Presumably the agency who has assumed the umbrella debt will not become the ‘employer’ for wider purposes – e.g. for any pay issues or to respond to any claims for unpaid

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<sup>1</sup> <https://www.legislation.gov.uk/ukxi/2003/2682/regulation/72/made>

statutory payments? It is worth saying, there may occasionally be National Insurance underpayments if the minimum wage element doesn't meet the Lower Earnings Limit. In these instances, we urge HMRC to ensure they credit workers with the relevant amounts so that they don't have gaps in their record.

- 5.5.6. **When should the power be used?** We think that recovery from another party should only take place where there is not *realistic prospect of recovery* from the umbrella company within a *reasonable period of time*. What is meant by 'realistic prospect of recovery' and 'reasonable period of time' will obviously need to be clearly defined. However what we will say at this juncture is that HMRC should not seek payment from the agency simply because it is too difficult to pursue the umbrella company – HMRC should use their full endeavours to recover the debt from the party ordinarily liable, in line with general principles, so as not to encourage even more reckless behaviour at umbrella company level. Indeed, there is probably an argument that HMRC should try and pursue the umbrella directors/controllers before thinking about transferring the debt to a non-defaulting party.
- 5.5.7. **Who should the debt be transferred to?** There is a well-known issue with agencies and individual recruitment agents receiving kickbacks and other financial incentives from non-compliant umbrellas to introduce workers to their services. Does HMRC need to consider extending the debt transfer provisions to anyone connected to the agency who has been party to the arrangements that caused the debt to arise? This could encompass directors, associates, or employees of the agency. If there is more than one potential party in scope – who should be targeted?
- 5.5.8. **HMRC processes.** HMRC will need to have a special team in place to ensure that any decisions made in this space are fair and consistent. HMRC will be under the spotlight in terms of transparent and timeous use of these powers. It would be unfair to agencies, who are potentially liable and in a very uncertain position anyway, for HMRC to transfer debts in some instances but not others (where facts are similar) or let an issue at umbrella company level drift, increasing the size of the liability/debt to be transferred. In the same vein, once a debt transfer has been effected, HMRC would need to take extra care to not let the same players back into the system (by way of a phoenixed company for example – see para 4.2.4), for the same issues to simply arise again.
- 5.5.9. **Safeguards.** For example, a debt transfer notice will be required to be served, containing sufficient information to allow the recipient to identify if and how they can appeal. There should be a number of appeal grounds available, including whether they have taken reasonable care to ensure the integrity of the supply chain, notwithstanding that the umbrella failed to pay its debts.

## 6. Chapter 5 – Targeted options to address tax non-compliance

### 6.1. Question 43: What benefits does the scheme currently provide when compared to other accounting simplification measures (e.g. the annual accounting or cash accounting schemes) and, in particular, what additional (if any) benefits are there to those enabled by Making Tax Digital for VAT?

- 6.1.1. Flat Rate VAT and Making Tax Digital (MTD) for VAT are intended to fulfil two separate policy objectives. MTD for VAT requires digital record keeping and the use of commercial software to submit VAT returns. In our view this process does not, in itself, make the Flat Rate VAT scheme less

attractive to those who find it a much simpler way of dealing with their VAT obligations. The Flat Rate VAT scheme offers small businesses who meet the eligibility conditions a simpler way to work out the VAT that they need to pay over to HMRC.

6.1.2. While we have some concerns about the use of the Flat Rate VAT scheme (outside of mini umbrella companies),<sup>1</sup> we strongly oppose any wholesale changes being made to the regime without an open and wide consultation and a full and proper analysis as to impacts. This consultation should contain information about the main user groups (HMRC may need to commission research to understand this), how many limited cost traders there are, what checks (if any) HMRC do on flat rate categorisation on an application to join it and how many businesses de-register from VAT after the first year so take advantage of the 1% discount. Soliciting input in a formal dedicated consultation containing all relevant facts and supporting data would allow all stakeholders, including many VAT experts who are specialists in this field to offer sensible feedback on the future of the Flat Rate Vat scheme and maybe even offer useful suggestions as to other ways to tackle the mini umbrella company issue from a VAT perspective.

6.2. **Question 46: Do stakeholders agree, that if this option were implemented, it would help address abuse of the employment allowance?**

6.2.1. In order to reduce mini umbrella company abuse, HMRC are considering making it mandatory for a UK director to be in place to be eligible for the employment allowance. This is because mini umbrella companies usually have foreign nominee directors in place. However, the model could simply swap to using UK nominee directors (which are often used to set up the mini umbrella company before they are replaced by foreign ones and are also well in use to front DR umbrella companies).<sup>2</sup>

6.2.2. The intention here doesn't appear to be to stop the loss in the first place, but have somewhere to serve relevant notices, which is unfortunate (particularly where those notices are served on nominee directors). If HMRC want to stop the loss, they need to reconsider self-certification as to entitlement to the employment allowance in payroll software. While we appreciate that HMRC want to make processes quick and simple for taxpayers, to some degree it is this open front door that is being taken advantage of in this case. HMRC should either scrutinise employer applications to try and stop mini umbrella companies getting the PAYE reference they need in the first place (we understand mini umbrella companies are quite easy to spot), or explore whether it might be possible to remove the ability to self-certify entitlement to the employment allowance without causing too much disruption. If a basic manual application process was introduced for new employers, this would allow the matching of applications to active payroll records and remove the employment allowance from PAYE references that hadn't made an application.

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<sup>11</sup> For example, low paid workers in the gig economy seem to voluntarily register:

<https://www.litrg.org.uk/resources/guides-factsheets-and-checklists/tax-if-you-work-gig-economy/flat-rate-vat-gig-economy>

<sup>2</sup> <https://www.litrg.org.uk/latest-news/news/230628-press-release-tax-campaigners-issue-stooge-director-warning>

6.2.3. There appear to have been some extra requirements inserted in the R&D system to combat the levels of fraud in terms of requiring claimants to submit pre-claim notification forms and additional information.<sup>1</sup> An extra step in the ‘Becoming an employer’ process might be irksome but not insurmountable for bona fide employers and might just introduce enough friction to slow down the industrial scale creation and turnover of mini umbrella companies.

## 7. Final thoughts

7.1. While we are encouraged by this consultation, and in particular, HMRC’s tax options – it really has taken a long time to get to this point. It is important that once the consultation closes, decisions are made and implemented as soon as possible. In the meantime, we would urge HMRC to consider what more they can do to improve outcomes for workers.

7.2. For example we would like to see improved guidance to help workers navigate umbrella companies. Currently the content is heavily skewed towards DR. However, issues with umbrellas go beyond that and people need help understanding all manner of other things, including:

Preferred supplier lists	Pay uplifting	Holiday pay
Cloning	Cyber-attacks	Non-payment of wages
Margins	Mini-umbrellas	Missing auto-enrolment
Non provision of payslips	Growth share schemes	Expenses

7.3. We also think that the HMRC guidance needs to be linked to from the ‘Your rights as an agency worker page’<sup>2</sup> where there is currently no mention of umbrella companies despite significant numbers of agency workers being handed off to umbrella companies by agencies. The payslip guide<sup>3</sup> is not as useful as it could be – the key issue being that the payslip does not look like a realistic umbrella payslip as it doesn’t have the ubiquitous contractor reconciliation statement at the top.

7.4. In terms of worker communications and campaigns, while we welcome the progression in HMRC’s messaging around DR (for instance, in Spotlight 60 HMRC seemed to acknowledge that umbrellas might benefit from DR and that workers might be given little or no paperwork to support the planning), the inclusion of ‘legacy’ wording like ‘some people try to bend the rules of the tax system to pay less tax than they should’ in publications that recognise customers can be exploited by

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<sup>1</sup> <https://www.gov.uk/guidance/tell-hmrc-that-youre-planning-to-claim-research-and-development-rd-tax-relief>

<sup>2</sup> <https://www.gov.uk/agency-workers-your-rights>

<sup>3</sup> <https://www.gov.uk/guidance/check-your-payslip-if-you-work-through-an-umbrella-company>

umbrellas,<sup>1</sup> is confusing, inconsistent and means some workers at risk of being caught up in DR cannot self-identify as the target audience.

- 7.5. Finally, we would like to see the fact that HMRC seem to have acknowledged that there are other parties in supply chains that might hold some culpability and responsibility in terms of DR, better reflected in the current compliance and enforcement approach for DR. There is obvious tension between the precept that individuals are responsible for their own tax affairs and the law in the PAYE Regulations which says that employers are responsible for collecting income tax via PAYE and should be the first port of call when an underpayment is discovered. It is not clear to us to what extent HMRC are always following the PAYE Regulations and how they are ensuring decisions about who to pursue are made consistently and in line with the legislation. The fact there is no published compliance approach for DR just fuels this worry and speculation.

LITRG

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<sup>11</sup> <https://taxavoidanceexplained.campaign.gov.uk/>