

**Umbrella Companies: tackling non-compliance in the umbrella company market
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 This is a long awaited reform targeting tax non-compliance in the umbrella company market. This new chapter in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA)¹ sends a firm message that the government wants to protect workers from problems like disguised remuneration (DR) which can have a significant and negative impact on the life and well-being of low-income workers.
- 1.2 We are mainly focussed on looking at the reforms from the perspective of agency workers; we do not consider the draft legislation as it might apply when no agency is involved. With this in mind, overall we welcome the joint and several liability (JSL) approach as we think it is fair that agencies are made more accountable for the umbrellas in their supply chain. But in our view, success depends on operational delivery, visible enforcement, and a holistic approach, to prevent shifting risks and to truly protect workers. It is hard to know how clear and robust HMRC's plans are in this regard, when we do not have the detail.
- 1.3 We have a minor comment to make on the wording of the draft legislation, around the definition of the word "connected" in s. 61Z (2)(b)(i). We later flag a concern around umbrellas and agencies becoming connected to draw end clients into the liability (which could include public sector schools etc.), where no genuine connection exists. We also wonder whether legislation should contain specific record keeping/information powers for the different parties concerned in respect of JSL, to make sure the supply chain evidence is robust and enforceable.
- 1.4 We urge HMRC to produce and consult on detailed technical guidance at the earliest opportunity, well ahead of commencement. It should address the following points – with an emphasis on consistency and fairness – and also include worked examples where appropriate:

¹ <https://www.gov.uk/government/publications/umbrella-companies-tackling-non-compliance-in-the-umbrella-company-market>

- **Scope of PAYE liabilities** – Confirm whether JSL covers tax, National Insurance contributions (NIC), and Student Loan repayments, and whether recovered Student Loan repayments and/or NIC will be credited to workers to avoid gaps in their records. Set out clearly the position of agencies affected by this legislation for the Apprenticeship Levy (will their liability still depend on their own direct ‘pay bill’ or an amalgamation?) and other statutory purposes.
- **Quantifying liabilities** – Explain how liabilities will be calculated where HMRC may not have full information (particularly given potential limitations with Employment Intermediary reports), including how any pro-rata or reasonable apportionment might work.
- **Collection process** – Confirm if liabilities will be recovered via Regulation 80 determinations, whether in-year collection will be possible, and how appeals will be handled to avoid long delays.
- **Anti-avoidance** – Clarify how ‘purported umbrella’ provisions will be applied to non-employed arrangements (e.g. Construction Industry Scheme (CIS), Elective Deduction Model) and ensure genuine industry models are not unintentionally caught.
- **Ongoing operation** – State what happens after JSL is applied. Will the umbrella continue trading? Will the agency assume ongoing PAYE responsibility? How will phoenix companies be prevented from re-entering the market?

1.5 We also take the opportunity to set out some wider issues that may stem from this measure that may cause unintended consequences or cause other practical difficulties. These need careful consideration and building into HMRC’s approach and plans.

1.5.1 **Incentives for umbrellas** – If HMRC do not pursue umbrellas directly in most cases, this could encourage riskier behaviour and continued worker exploitation. HMRC need to be clear on the other powers that they might use to hold appropriate umbrellas accountable, and coordinate with other interested enforcement bodies such as the Fair Work Agency.

1.5.2 **Shift to unstable agencies** – Many agencies are micro-businesses with limited assets². If they are able to fold easily this will potentially create incentives for agencies and disreputable umbrellas to collaborate in avoidance behaviour. HMRC should consider using insolvency abuse powers to hold company directors personally liable for egregious conduct.

1.5.3 **Worker disruption** – for example, if agencies feel, as a result of these changes, that there is too much jeopardy, they may move workers to inhouse PAYE. HMRC need to prepare for and support workers facing tax code errors, cumulative pay/tax issues, or duplicate PAYE records when moving to new employers. A key question is whether some agencies might adopt similar practices to non-compliant umbrella companies in order to pass on new costs or responsibilities; and if they do, whether insolvency awaits if HMRC pursue them. This could create instability for agency workers. Additionally, HMRC will need to make sure that their compliance focus reflects the new rules and any emerging risks.

² According to the REC’s ‘UK recruitment industry status report 2023/24’, there were 31,247 recruitment enterprises in the UK at the start of 2024, with micro businesses (those with fewer than 10 employees) accounting for 78.6% of the workforce (up from 77.3% the previous year): <https://www.rec.uk.com/our-view/research/recruitment-and-industry-status-report/uk-recruitment-industry-status-report-202324>

1.5.4 PAYE Regulations 72/81 interaction – HMRC need to confirm when liabilities will (and will not) sit with workers and how JSL fits with counter avoidance’s early intervention approach where workers are informed they are in DR within two months and are invited to exit it and settle their tax affairs. In our view, for this new initiative to work, and to ensure HMRC cannot recover the same liability twice from different parties, HMRC will have to stop pursuing workers for underpaid PAYE in situations where they might currently do so. They should potentially alert the agency to any suspected issues instead.

1.6 Finally, we note that another major reform is set to apply from April 2026 – the requirement for tax advisers who interact with HMRC on behalf of their clients to register with HMRC and meet minimum standards³. We understand that external payroll providers will fall under the definition in the legislation but what about umbrella companies? If umbrella companies are intended to be covered by this legislation, HMRC must be mindful that the implementation date coincides with the commencement of joint and several liability – potentially a lot for umbrellas to contend with.

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 who are least able to pay for professional advice. We also produce free information, primarily via our website www.litrg.org.uk, to help make a difference to people’s understanding of the tax system.

2.2 LITRG works extensively with key stakeholders such as HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward ideas for improving the tax system. LITRG also considers the welfare benefits system, and other related systems, to the extent that they interact with tax.

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 The Government announced at Budget 2024 that it would bring forward the third of three strategic options for preventing tax non-compliance within the umbrella company market – deeming the employment business (usually known as the recruitment agency) that supplies the worker to the end client to be the employer for tax purposes.

3.2 One way of giving effect to this was for HMRC to require a party further up the labour supply chain to operate PAYE on payments to workers. Practically speaking, this would have meant that agencies

³ <https://www.gov.uk/government/publications/modernising-and-mandating-tax-adviser-registration-with-hmrc/requirement-for-tax-advisers-to-register-with-hmrc-and-meet-minimum-standards>

would no longer be able to rely on umbrella companies to operate PAYE in their capacity as the employer of the workers. The workers would have to have their taxes etc. administered under the employer PAYE reference of the agency.

- 3.3 Having listened to feedback on the potential disruptive effects of this on workers and the temporary labour market, HMRC have chosen another way to give effect to option 3 – via a joint and several liability (JSL) mechanism. This will allow umbrella companies to continue to hold the employer's reference number and pay workers through their own PAYE payrolls. But it means that if they default on their PAYE obligations, HMRC will hold the agency (or sometimes, the end client) responsible instead.
- 3.4 The measure aims to target the structural use of PAYE avoidance to increase competitiveness or profitability in labour supply chains — for example where DR is used to artificially inflate take-home pay or reduce tax liabilities. Such schemes often involve the umbrella company employer failing to operate PAYE properly. Although the law says the employer should really be responsible for this, HMRC's current approach can result in workers themselves receiving unexpected tax bills, even where they did not have an avoidance motive⁴. These new rules shift accountability up the supply chain.

4 Our comments on the policy and legislation

- 4.1 Firstly, we would like to commend HMRC on the policy development process that led to this draft legislation. HMRC have listened to stakeholders and drawn on external perspectives and expertise throughout and as a consequence have arrived at a significant, but proportionate, intervention that represents a step change in how HMRC deal with umbrella companies.
- 4.2 In our view the draft legislation itself⁵ is good and clear, subject to the following:
- **Definition of 'connected'**: What definition are HMRC proposing to use of 'connected' in s. 61Z (2)(b)(i)? If it is a broad or unclear definition, it could mean many umbrellas and agencies are connected, drawing end clients into the frame, in situations where they may not have anticipated this.
 - **Record-keeping and information powers**: Regarding the extended s716B duty, if HMRC expect all the different parties concerned to hold specific supply chain records to assist in JSL enforcement, these should be clearly specified in the legislation or regulations. Similarly, are current information powers sufficient to enforce JSL or are additional targeted powers needed?

⁴ Presumably because HMRC are of the opinion that the employee has received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments: <https://www.legislation.gov.uk/uksi/2003/2682/regulation/72>

⁵

https://assets.publishing.service.gov.uk/media/687a77e6312ee8a5f0806bc6/7132_Draft_legislation_Umbrella_s.pdf

5 HMRC's operational approach and guidance

- 5.1 Although we think the principle and law are largely sound, we have some questions as to how ready HMRC are to operate and enforce the new rules in order to deliver the intended outcomes. Obviously, HMRC must use and be seen to use these new rules, otherwise the same problems will continue to exist and the key benefits to workers (and the Exchequer) will not be fully realised. But it is hard to know how workable the rules are in practice, how robust HMRC's enforcement plans are and therefore how successful implementation will be, when we do not have the detail.
- 5.2 This kind of technical detail is typically contained in HMRC's manual guidance. We would therefore urge HMRC to produce and widely consult on this new guidance as soon as possible to allow stakeholders to comment on HMRC's proposed approach and to help make sure it is as comprehensive and helpful as possible.
- 5.3 We set out some of the main questions below that we have about how JSL will work in practice, which we would like to see dealt with in HMRC's guidance:
- 5.3.1 **Scope of PAYE collection?** We assume that it will not only cover tax and NIC, but also Student Loan repayments⁶. If these end up being recovered from the agency, will they be paid over to the Student Loans Company? It is also worth saying, there may occasionally be NIC underpayments as a consequence of umbrella practices like DR. In instances where NIC is recovered from agencies, we urge HMRC to ensure they credit workers with the relevant amounts so that they don't have gaps in their record. More broadly, we understand the agency who has assumed the umbrella liability will **not** become the 'employer' for wider purposes – e.g. for any pay/deduction issues⁷ or to respond to any claims for statutory payments or employment rights. If this is the case, it is important that all parties concerned understand this. Similarly, what about the Apprenticeship Levy? If a liability passes to the agency will HMRC amalgamate their normal NICs liability on their direct employees with the assumed NICs liability from the umbrella to determine whether (and the amount of) any liability?⁸
- 5.3.2 **Quantifying the liability** – For DR cases, we assume HMRC will try and match Real Time Information returns with any available data on the assignment rate, to accurately identify potential gaps in taxable earnings on an individual basis. Employment Intermediary reports⁹ could be particularly helpful in this regard, but it is worth HMRC clarifying requirements when workers are passed by an

⁶ <https://www.legislation.gov.uk/uksi/2009/470/regulation/42/made>

⁷ For example, if there are minimum wage underpayments or issues around attachment of earnings (given the legal authority for deduction doesn't come from ITEPA 2003 or the PAYE regulations?)

⁸ The levy is charged based on amount of 'pay bill' - all payments subject to Class 1 secondary National Insurance Contributions (NIC)

⁹ <https://www.gov.uk/government/publications/employment-intermediaries-reporting-requirements>

agency to an umbrella¹⁰. However, there may be other instances where liabilities cannot be accurately determined and will have to be estimated, for example where one or both data sources are missing or where the PAYE due at the end of a tax month is only partially remitted. In some situations, given umbrella companies house hundreds or thousands of workers from multiple agencies, we assume some kind of pro-rata or other reasonable apportionment method will be necessary to allocate liability to particular agencies.

5.3.3 **Collecting the liability** – Presumably, this will be via a Regulation 80 determination¹¹, although these are not typically used to collect in-year. In addition, our experience is that Regulation 80s can sometimes be issued late in the day and based on estimated information only, which seems less than ideal in this context. Do HMRC propose to introduce some kind of in-year collection? HMRC should confirm the scope of Regulation 80 appeal rights for agencies subject to JSL, including the ability to challenge the underlying PAYE determination and any estimated figures, bearing in mind the potential for this to introduce long delays.

5.3.4 **Anti avoidance** – Because these new rules pivot on ‘employment’, we understand the ‘purported umbrella’ proposals are intended to cover issues such as gross payment status and subcontracted personal service companies (PSCs) where workers are not ‘employed’. However the use of supposition and assumption is problematic in the purported umbrella provisions, as it may catch genuine arrangements where an umbrella does not operate PAYE for legitimate reasons. This happens in the construction industry. If CIS arrangements are not intended to be covered by this legislation, HMRC should set this out clearly. HMRC should also set out their view of other models like Elective Deduction Model¹² in relation to Chapter 11, given these could also be used to try and swerve the rules (for instance, people might think ‘employed’ can be avoided by giving someone a contract for services for employment law purposes).

5.3.5 **Other points** – Including commencement provisions and other practicalities – for example, around HMRC processes. It strikes us that 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 timely use of these powers. It would be unfair to agencies, who are potentially liable and in a very uncertain position anyway, for HMRC to use Chapter 11 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 for the agency. In the same vein, once JSL has been used, it is unclear what will happen. Will the umbrella be allowed to continue as an employer? Will the agency have to assume

¹⁰ It appears that, currently, agencies may not need to include the amount paid for the workers services and other important details where they are passed to an umbrella and this is treated as category F: <https://www.gov.uk/government/publications/employment-intermediaries-report-template/how-to-use-the-employment-intermediaries-template>

¹¹ The Income Tax (Pay As You Earn) Regulations 2003: <https://www.legislation.gov.uk/ukSI/2003/2682/contents>

¹² Explained further here: <https://www.litrg.org.uk/blog-post/elective-deductions-model-edm-explainer-advisers>

the PAYE function on an ongoing basis? HMRC would need to take extra care to not let the same players back into the system (by way of a phoenix company for example), for the same issues to simply arise again.

6 Wider issues for HMRC to consider

6.1 There are four wider issues potentially stemming from JSL, that we think may cause unintended consequences and which need building into HMRC's approach and plans.

6.2 Incentives for umbrellas

6.2.1 We understand that in order to give effect to option three via JSL, apart from for some minor payroll/payment discrepancies, HMRC will go straight to the agency. There will be no statutory defence. For example, agencies will not be able to avoid liability by carrying out appropriate due diligence such as checks on umbrellas, or in instances where they were deceived by the umbrella or where the umbrella makes a mistake resulting in an underpayment or there has been a genuine business failure (although good checks will of course reduce practical risk).

6.2.2 If HMRC will not take any steps to recover the amount due from the umbrella company, we think this could encourage even more reckless behaviour at umbrella company level. This means workers may still be at risk of tax and employment law abuses such as non-payment of holiday pay – which are in and of themselves problematic but can also suppress workers' taxable pay.

6.2.3 To avoid this, it is vital that HMRC set out their expectations of umbrellas and in the more extreme cases, research and clearly set out what other powers there are that they and other government agencies (for example the new Fair Work Agency) could use ensure umbrellas are accountable.

6.3 Will the problem just shift?

6.3.1 We are concerned about what might happen if the umbrella company's liability is not underpinned by a sensible, robust, established agency.

6.3.2 Ultimately HMRC hope that Option 3 will lead to agencies having a tighter control over tax compliance. But we are also aware that many agencies are micro agencies – so employ fewer than 10 people, which could make collecting any taxes that are owed quite hard (as they would probably be as asset-light and easily foldable as an umbrella company).

6.3.3 This could mean that some agencies could have a 'here today, gone tomorrow' mindset and remain unconcerned about the umbrella companies they contract with. Also, if end clients are basically the ultimate backstop in more situations than we think (see para 4.2), this could lead to less reputable agencies/umbrellas working together to avoid accountability under the new rules. In these instances, workers will remain at risk and the important benefits of this legislation will not be realised.

6.3.4 HMRC need to be prepared for some short termism/gaming of the rules, ensure that they have ways to get early warning of such behaviour and consider their strategy for dealing with it. For example, in the face of egregious behaviour, one option would be for HMRC to strengthen their position by

setting out how they might use their insolvency abuse powers¹³ to hold company directors/controlling minds personally liable.

6.4 Changes in arrangements

6.4.1 JSL could significantly change the landscape for workers. HMRC will need to be ready and resourced to deal with this, including in terms of providing the support that workers will need to understand any changes to how they are engaged. Some likely implications include:

- Increased vetting of umbrella companies before they're added to preferred supplier lists – this could result in fewer umbrella company options and may mean workers have to switch providers
- Heightened reluctance by agencies to work with umbrella companies – agencies may move more workers onto in-house PAYE/direct contracts to reduce exposure.

6.4.2 In both scenarios, there will be a change of employer for tax purposes – the employment with the old umbrella company will be terminated and the new umbrella/the agency will become the new employer for tax purposes. This sounds simple but can significantly affect workers. In particular, from a tax perspective, they will have to go through the leaver/starter payroll process which can mean:

- workers may be issued a new tax code which can lead to temporary adjustments in how their tax is calculated, potentially resulting in overpayments or underpayments until resolved.
- if the transfer is not managed seamlessly, workers might experience issues with cumulative taxation, where their tax history from the previous employer isn't properly accounted for by the new employer. This can result in incorrect deductions.
- in some cases, duplicate PAYE records can be created or HMRC might incorrectly view the worker as having multiple jobs, which can complicate their tax position and require rectification.

6.4.3 In brief, there may be some disruption for workers and they might need to interact with HMRC to correct tax codes, address overpayments or underpayments, or resolve discrepancies. Another key question for us, is whether some agencies might adopt similar practices to non-compliant umbrella companies in order to pass on new costs or responsibilities; and if they do, whether insolvency awaits if HMRC pursue them. It is our view that HMRC will need to make sure that their customer service function is adequately resourced to provide support for the new rules and that the compliance focus reflects any emerging risks.

6.5 Regulation 72/81 interactions

6.5.1 HMRC currently use real-time data to identify individuals who may be in DR schemes. They then write to them within two months, advising how to exit before large tax liabilities build up. In order

¹³ <https://www.gov.uk/guidance/overview-of-joint-and-several-liability-notice-for-tax-avoidance-tax-evasion-and-repeated-insolvency>

for JSL to have its intended impact — namely, refocusing everyone in the labour supply chain on the correct operation of PAYE — it appears that HMRC will need to stop pursuing workers for PAYE underpayments arising from DR schemes and instead direct the bill to the agency.

6.5.2 But what of other PAYE underpayments or underpayments arising from DR schemes where the worker has chosen to take a risk in a non-compliant scheme when it *may* be appropriate to chase the worker rather than the agency? Basically, it is unclear to us how HMRC intend Regulation 72/81¹⁴ or even section 684 (7A) ITEPA 2003¹⁵ to work in conjunction with the new Chapter 11 powers. We would like HMRC to clarify their position as soon as possible and set out when, if ever, liabilities could sit with workers.

6.5.3 It is important that this work is ‘joined up’ with counter avoidance and that between the two different parts of HMRC they determine how operational processes will need to change to reflect the new rules. We believe it would be helpful for HMRC’s counter avoidance and other relevant teams to now publish a joint strategic paper outlining their shared approach to DR and umbrella companies. This paper should clearly set out how policy and compliance functions will collaborate after April 2026.

7 Final thought

7.1 Finally, it occurs to us that another major reform is set to apply from April 2026 – the requirement for tax advisers who interact with HMRC on behalf of their clients to register with HMRC and meet minimum standards¹⁶. We understand that external payroll providers will fall under the definition in the legislation¹⁷ but what about umbrella companies? Although they operate payroll, they operate it in the capacity as an employer (and so in relation to their own PAYE obligations), not an external payroll provider. However arguably they do so in the course of a business – their business being the administrative go-between for agencies and workers (their clients?). They may also sometimes influence a person’s tax position or offer advice to their clients in conjunction with running payroll, for example around the ‘benefits’ of certain remuneration structures (which may not be tax compliant).

7.2 Are umbrella companies intended to be in scope of these measures? We assume so, given this whole initiative was borne out of the Amyas Morse review into the disguised remuneration loan charge, in which he made the following recommendation: ‘The Government must improve the market in tax advice and tackle the people who continue to promote the use of loan schemes, including by

¹⁴ The Income Tax (Pay As You Earn) Regulations 2003:

<https://www.legislation.gov.uk/uksi/2003/2682/contents>

¹⁵ <https://www.legislation.gov.uk/ukpga/2003/1/section/684>

¹⁶ <https://www.gov.uk/government/publications/modernising-and-mandating-tax-adviser-registration-with-hmrc/requirement-for-tax-advisers-to-register-with-hmrc-and-meet-minimum-standards>

¹⁷ Because payroll work affects tax outcomes and involves direct submissions to HMRC, providers are treated as tax advisers and therefore must register under the mandatory regime.

clarifying how taxpayers can challenge promoters and advisers that may be miss-selling loan schemes. There should be a new strategy published within 6 months, addressing how the Government will establish a more effective system of oversight, which may include formal regulation, for tax advisers¹⁸.

- 7.3 If this is what is intended, HMRC must be mindful that the implementation date coincides with the commencement of joint and several liability. Potentially, this leaves a lot for umbrellas to contend with and could also be very disruptive in and of itself, particularly if umbrellas cannot meet the conditions to interact with HMRC.

LITRG
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https://assets.publishing.service.gov.uk/media/5dfca55d40f0b6661e94aa1b/Independent_Loan_Charge_Review_-_final_report.pdf