

## Tackling non-compliance in the umbrella company market

### Response by the Chartered Institute of Taxation

#### 1 Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 The CIOT sets out below its views on proposals to tackle non-compliance with both tax and employment rights by umbrella companies. Our comments are mainly limited to the proposals in respect of tax compliance (Chapters 4 and 5) although we make some observations in respect of regulating umbrella companies (Chapter 3).
- 1.3 We agree with the government that the aims of this consultation should be to deliver improved outcomes for workers, to support a level playing field in the umbrella company market, and to protect taxpayers from the significant revenue losses that currently arise from non-compliance. At the same time we believe that the measures that may be introduced to achieve these aims should be focused and proportionate, and we refer to this further below.
- 1.4 While we are not in a position to comment in detail on the proposals to define an umbrella company and regulate them, we do agree that regulation would help to weed out the 'bad apples' and would be a step towards meeting the government's three aims.
- 1.5 In regard to tackling tax non-compliance, we think that first and foremost those facilitating the non-compliance and fraud, including the owners and providers of the umbrella companies should be held personally liable for taxes not correctly accounted for. In particular, we note that in many cases the worker is an innocent party in these transactions.
- 1.6 Options 1 and 2 set out in Chapter 4 of the consultation document would impose a due diligence requirement (Option 1) and a transfer of the umbrella company's tax debt (Option 2) on the end client and employment

business. Both these options could place considerable administrative burdens on businesses (under Option 2 a business would effectively be required to conduct due diligence to manage the transfer of tax debt risk) and so we think they would need to be framed very carefully. Furthermore, a potential transfer of tax debt away from the umbrella could mean that the umbrella company model is considered too risky by end-clients and employment agencies. In any event we also believe that more needs to be done to enable HMRC to recover tax directly from the umbrella company itself and we elaborate on this further below.

- 1.7 In particular, if the requirements placed on businesses for due diligence are reasonable, proportionate, and clear (and businesses are not penalised if things inadvertently go awry), we think that employment businesses and end clients may be content to live with this, ie not change their business models. And this would then allow good umbrella companies to operate in the market while driving out many of the non-compliant umbrellas. However, if the requirements on business are excessive, it is unlikely that businesses will want to engage workers via an umbrella company.
- 1.8 However, a better option might be for HMRC to maintain a list of registered umbrella companies who satisfy designated requirements around tax compliance such that employment businesses and end clients can check that the umbrella company they propose engaging is on this list. This approach has worked well for many years in respect of the Construction Industry Scheme's Gross Payment Status requirements to mitigate tax lost and drive up compliance.
- 1.9 If either Options 1 or 2 are implemented clear regulations will be required to identify what steps the employment business and end client must take to ensure that they have taken reasonable care in complying with the due diligence requirements and in checking that the umbrella company will comply with its tax obligations.
- 1.10 The legislation should be supported with clear guidance (including examples) on the requirements and an appealable defence that the relevant party took reasonable care, plus mitigation for actions subsequently taken to address the failures, so that any penalties are fair and proportionate. And, in particular, that the bar is set at a reasonable level before there is any transfer of tax debt away from an umbrella company.
- 1.11 In regard to Option 3 (placing the PAYE obligation on the employment business), as a general rule we think the responsibility to account for PAYE/NICs should, in the first instance, rest with the legal employer. However, we can see the argument for Option 3 as regards rooting out non-compliance in that employment businesses operate under an established regulatory framework. If this option is taken forward, we suggest that the deemed employer be the employment business closest to the umbrella company (as is the case under the Off-Payroll Working rules) rather than the employment business closest to the end client (as applies under the agency workers legislation). This is because employment businesses often work very closely with umbrella companies in any event. One concern that occurred to us with this option is whether it could drive out good umbrella companies that already meet their tax obligations. However, since Option 3 would maintain the status quo as regards who the employer is for employment law purposes, it seems to us that the non-tax benefits of engaging workers via an umbrella company would be retained. And, in all likelihood, since this option requires the employment business to operate a payroll, it may well be that a number would in any event delegate this to the umbrella companies (ie acting as a payroll bureau) in any event. So the work done by the umbrella would then essentially stay the same, but crucially the responsibility to HMRC for PAYE/NIC would rest with the employment business.

## 2 About us

- 2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 2.2 The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 2.3 The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.4 Our members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

## 3 Introduction

- 3.1 The CIOT is responding to a consultation seeking views on proposals to tackle non-compliance with both tax and employment rights by umbrella companies. It should be noted that the main role of umbrella companies in the labour market is to employ temporary workers on behalf of employment businesses and end clients.
- 3.2 This consultation follows an earlier call for evidence, which the CIOT responded<sup>1</sup> to. This call for evidence found<sup>2</sup> that cost considerations around hiring workers led engagers towards using umbrella companies and away from direct hires. Also that the main disadvantage of using umbrella companies was non-compliance with tax and employment rules. And that for the majority of workers they had no option but to take up an employment through an umbrella company, otherwise they would lose the work.
- 3.3 The government’s stated objectives for the umbrella company market 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.
- 3.4 Our stated objectives for the tax system include:
- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
  - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
  - Greater certainty, so businesses and individuals can plan ahead with confidence.

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<sup>1</sup> [Umbrella Company Market \(tax.org.uk\)](https://www.tax.org.uk)

<sup>2</sup> [M4027 Call for Evidence SoR UCs 0103.pdf \(publishing.service.gov.uk\)](https://www.publishing.service.gov.uk)

- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

#### **4 Regulating umbrella companies for employment rights**

4.1 While the Employment Agency Standards (EAS) Inspectorate is the state regulator for the recruitment sector in Great Britain, we understand that umbrella companies are generally unregulated at present, which often means there are no practical consequences for the umbrella company for non-compliance with employment law.

4.2 Although the government has committed to regulate umbrella companies this first means defining what an umbrella company is and then deciding what regulations are to apply to them. This consultation puts forward two options for defining an umbrella company.

##### **4.3 *Option 1: Defining umbrella companies and limiting acceptable engagement structures.***

Under this option an umbrella company would be defined in the following way:

- a person or business (whatever their legal form) who may be engaged as a ‘corporate work-seeker’ by the employment business to employ or engage an individual looking for work; and
- the umbrella company would employ or engage that individual with a view to them being supplied to carry out work for a hirer, in line with arrangements between an employment business and a hirer.

4.4 Also, under this option, only four methods of engagement and payment methods would be permitted. These are:

- Model 1 – the employment business directly employs the individual work-seeker (under a contract of service), and no umbrella company is involved. This model is already covered by the current legislation.
- Model 2 – the employment business directly engages the individual work-seeker (under a contract for services), and no umbrella company is involved. This model is already covered by the current legislation.
- Model 3 (umbrella company model) – the employment business directly engages a corporate work-seeker (which will be an umbrella company) not controlled by the individual doing the work. This lack of control of the corporate work-seeker distinguishes it from model 4 below.
- Model 4 – the employment business engages the individual’s Personal Service Company (PSC), which the government proposes to define narrowly for the purposes of this approach. A business would only be considered a PSC for the purposes of this option if it is under the control of the individual worker and that individual is the only person made available by the company. This model is already covered under current legislation.

##### **4.5 *Option 2: Defining umbrella companies by applying three tests.***

Under this option to be an umbrella company the company must meet three conditions. The three proposed conditions that a business should meet to be considered an umbrella company under this option are as follows:

- *Condition 1* – there should be two separate businesses (an employment business and end client) involved in supplying the worker in addition to the umbrella company.
- *Condition 2* – the putative umbrella company has a direct contractual relationship with the individual to be supplied to an end-hirer that makes the umbrella company responsible for paying the individual the agreed rate. But the putative umbrella company is not responsible for providing work-finding services, which remains the function of the employment business.
- *Condition 3* – the putative umbrella company receives a form of commission or fee, often referred to as their ‘margin’, for the service they have provided as an umbrella company. This will most commonly be deducted from the individual’s gross pay by the umbrella company, which makes up part of the total gross amount it receives from the employment business, whether directly or indirectly. This should be indicated on the Key Information Document (KID) if this is to be the case.

**4.6 Question 1: Which of the options would be the most effective way to define umbrella companies to ensure only they are brought in scope now and ensure future regulations/standards can be targeted to the right business in the supply chain? Please explain your answer.**

- 4.7 As a tax professional body we are not in a position to comment on the most effective way to define umbrella companies. We would, however, make a number of general observations in regard to the two options.
- 4.8 We agree, in principle, that amending the definition of an employment business (Option 1) (see 3.14 of the consultation document) to distinguish between (i) employment businesses providing work-finding services and (ii) umbrella companies that would not normally provide such services would be helpful.
- 4.9 One aspect of defining an umbrella company that we think may need to be considered is to ensure that there are no circumstances where a company may ‘accidentally’ be defined as an umbrella company. For example, a service company within a group of companies, or a temporary secondment from one company to another. In these situations, there would be no employment business involved, so hopefully not. But in framing an appropriate definition we think this point should be confirmed.
- 4.10 At paragraph 3.12 of the consultation document (Option 1) there is reference to an umbrella company being a ‘*business ... who may be engaged as a corporate work-seeker*’. The use of ‘may’ in the definition implies some uncertainty: could the business still be an umbrella company if they are not engaged as a corporate work-seeker? If so, in what circumstances? We also understand that there may be some uncertainty as to whether an umbrella would be a ‘*corporate work-seeker*’. In particular, we note that umbrella companies do not engage in ‘work-finding services’ and so the semantics here seem a bit confusing.
- 4.11 We are concerned that Option 1 also proposes restricting engagement/payment methods to four methods in so far as they involve employment businesses. It seems to us that the government should not restrict the way that people can be hired to work in the UK (albeit various exceptions to this are proposed at paragraph 3.21 of the consultation document). To do so could well mean that there are inadvertent consequences, even if these cannot be fully identified at this stage.
- 4.12 Overall, considering both options, we think that Option 2 is likely to be the simplest way to define an umbrella company because the tests/conditions are relatively easy to understand. This said, some form of targeted anti-avoidance provision may be appropriate to prevent non-compliant umbrella companies from circumventing being regulated.
- 4.13 **Question 2: Which of the definitions would be the most future proof? Please explain your answer.**

- 4.14 See our comments above in response to Question 1.
- 4.15 **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.**
- 4.16 We think that with Option 1, because it would be more difficult for an ordinary worker to understand the proposed definition of an umbrella company, a non-compliant umbrella company could mislead a worker into believing the rules do not apply to their engagement. Also, the restriction on methods of engagement and payment could restrict flexibility when engaging labour.
- 4.17 An alternative simple definition might be 'a person or business that supplies individuals but does not find the work that the individual undertakes' (albeit an exclusion for the circumstances described at paragraph 4.9 would still be needed).
- 4.18 **Question 4: What aspects of the umbrella company's role in the supply chain should the regulations cover?**
- 4.19 The consultation document has identified the key areas that are giving rise to problems when engaging through an umbrella company, such as workers not receiving their pay or holiday pay. It seems to us that the regulations should cover these areas and should be regularly reviewed and updated to include other issues that come to prominence over time.
- 4.20 The regulations could also cover due diligence requirements, such as what information an umbrella company must provide to an employment business to assure that business the umbrella company is compliant with all regulations and legislation that applies to is.
- 4.21 Another aspect the regulations could deal with is the margin deducted from the fee received from the employment business, to ensure that it is fair and not excessive.
- 4.22 **Question 5: Is there a rationale for starting with limited regulations and reviewing them before potentially expanding them to cover other areas of umbrella company involvement? Please explain your answer and illustrate with examples.**
- 4.23 See our response to Question 4 at paragraph 4.19 above. Starting with limited regulations means it will be easier for everyone to know what they are and get things right in those areas, which will be the key priority areas as mentioned in the consultation document.
- 4.24 **Question 6: Are there reasons that the Employment Agency Standards Inspectorate should not enforce umbrella company regulations? And if so, are there other bodies or approaches the government should consider? Please explain your answer.**
- 4.25 In 2019 the government consulted<sup>3</sup> on establishing a new Single Enforcement Body (SEB) for employment rights. Consultation responses showed there was a real opportunity to deliver more effective enforcement of employment rights for vulnerable workers and the outcome of the consultation was that the government would proceed with plans to bring together the existing labour market enforcement bodies. Whilst we understand that this work has now been paused, we think that the SEB would have been well-placed to regulate the umbrella company market.
- 4.26 In the absence of a single body the Employment Agency Standards Inspectorate (EAS) may be an appropriate body to enforce umbrella company regulations, subject to them being adequately funded and staffed to

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<sup>3</sup> [Good work plan: establishing a new single enforcement body for employment rights - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/good-work-plan-establishing-a-new-single-enforcement-body-for-employment-rights)

perform such a function. We understand though that the EAS is currently a very small body so, at present, they may not be the best option, and that the Gangmasters and Labour Abuse Authority (GLAA) may be a better option. In addition, whichever body ultimately regulates umbrella companies, HM Revenue & Customs (HMRC) will be the body that enforces their tax compliance and joint working of cases by both bodies should be facilitated.

- 4.27 ***Question 7: Does the Employment Agency Standards Inspectorate have sufficient enforcement powers to regulate umbrella companies or would changes need to be made? Please explain your answer.***
- 4.28 This question is not within the remit of the CIOT. As a general observation, whichever body enforces the regulations will need information powers to obtain whatever information is necessary to ensure compliance.
- 4.29 ***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.***
- 4.30 This question is not within the remit of the CIOT. As a general observation, proactive compliance inspections are likely to act as a deterrent to bad behaviour provided there are appropriate sanctions. A requirement for umbrella companies to be licensed could also be considered.

## 5 Tackling tax non-compliance in the contingent labour market

- 5.1 It is understood that there are several types of tax non-compliance in the umbrella company market, including fraudulent and ineffective disguised remuneration tax avoidance arrangements. HMRC already has the Disclosure of Tax Avoidance Schemes (DOTAS) (and related) legislation at its disposal (which has been significantly enhanced in recent years) and we understand HMRC is taking robust actions to tackle the promoters and providers of these schemes.
- 5.2 This consultation invites views on three options and how each option could best be designed to meet the objectives that are set out for each, as well as the potential impacts of each option.
- 5.3 ***Option 1: Mandating due diligence***
- Under this option the government would require organisations contracting with umbrella companies to carry out a minimum level of due diligence on that umbrella company.
- 5.4 ***Question 9: Do you agree that a requirement to undertake due diligence upon any umbrella companies which form part of a labour supply chain would reduce tax non-compliance in the umbrella company market, and to what extent?***
- 5.5 In principle, we think that undertaking due diligence on any umbrella companies forming part of a labour supply chain should indeed reduce tax non-compliance. This said, we also think that, as far as possible, it is also important to target those that are non-compliant (the bad eggs) rather than add to the burdens of those that are compliant. Accordingly, we consider the question to be more around what particular obligations, if any, should be imposed and on whom – the end client, the employment business(es), other parties in the supply chain? And will these obligations be proportionate to the size of the problem? For example, what time/costs would they entail and what more is being asked than already represents best practice in dealing with umbrella companies? Any due diligence requirements need to be proportionate and not impose undue burdens.

- 5.6 One option, not considered in the consultation document, but which we think has merit may be to adopt a Construction Industry Scheme (CIS) registration/gross payment status (GPS) approach. Under this approach HMRC would maintain a list of registered umbrella companies who satisfy designated requirements around tax compliance and employment businesses and end-clients could then check that the umbrella company they are dealing with is on the 'approved' list as being tax compliant. This approach worked well when CIS was introduced in the 1970s, as it addressed serious non-compliance issues in that sector – and it has continued to operate pretty much unchanged to this day. We think that a similar approach could be equally effective in tackling tax non-compliance by umbrella companies. In this respect, it would need to be decided whether only registered umbrella companies could legitimately operate in the marketplace or whether registration on the list was more of a kite mark for those end-clients/employment agencies that wanted reassurance that the umbrella company they were engaging with was compliant.
- 5.7 Another option might be to require umbrella companies (or their owners and managers) to be registered with an appropriate regulating body (such as the CIPP) and have to adhere to the standards of that body.
- 5.8 ***Question 10: Would a mandatory due diligence requirement focused on tax non-compliance also improve outcomes for workers engaged via umbrella companies?***
- 5.9 While a mandatory due diligence requirement may reduce tax non-compliance by umbrella companies, which would benefit workers insofar as they could be confident that their taxes have been properly accounted for and paid, the question is what the cost of this due diligence would be to the end client, employment businesses and tax-compliant umbrella companies. In addition, whether any of this cost would be passed on to the worker by way of reduced wages.
- 5.10 ***Question 11: Which parties in a labour supply chain should be required to comply with a due diligence requirement?***
- 5.11 It seems to us that if the employment business is making the introduction to the umbrella company then the employment business should have this responsibility. Of course, we would expect a prudent client would nevertheless want to undertake its own due diligence in any event and, since the end client is usually the party driving the costs of the engagement, it may be equally appropriate to hold them to account if, for example, a decision to cut costs impacts compliance.
- 5.12 ***Question 12: Which due diligence checks are most effective for identifying potential tax non-compliance in labour supply chains?***
- 5.13 See our comments in response to Question 9 and, in particular, our suggestion at paragraph 5.6 that HMRC maintain a list of recognised tax-compliant umbrella companies.
- 5.14 There is no one, or two, etc checks that are effective on their own. Effective checks of whether a business is 'good' or 'bad' involve cumulative evidence and may include references from well-known/large clients, evidence of how long the umbrella company has operated for, a physical location in the UK, up-to-date company accounts, VAT registration, accreditation with a professional body, face-to-face meetings with the umbrella company's directors/staff, ability to appoint an external party to review the umbrella company's payroll, confirmation that PAYE/VAT/Corporation Tax submissions have been made on time and taxes paid by their due date, etc. And good/bad feedback or absence of issues raised across social media platforms can also be a valuable indicator. Ultimately, guidance will be needed as to the checks that have to be undertaken to be considered 'reasonable' and what should be done by way of further assurance if an umbrella company fails one check (for example, has been late paying their VAT). The other aspect is whether legislation should



be enacted to require umbrella companies to provide particular information to employment agencies/end-clients as a pre-requisite to operating as such.

- 5.15 We also consider that the government should consider whether it would be appropriate to require that umbrella companies are incorporated and managed in the UK with UK-based directors. In this way it would be much easier for enforcement action to be taken if and when needed. (And noting that, as the UK is no longer a member of the EU, then the government may be freer to take this approach if it considered it appropriate to do so).
- 5.16 ***Question 13: What due diligence checks could end clients or employment businesses be reasonably expected to carry out upon umbrella companies within their labour supply chains? Which tax heads should the checks cover (eg employer duties, VAT, Corporation Tax, etc.)?***
- 5.17 See our comments in response to Questions 9 and 12. We would add that we think it would also be helpful to be able to check direct with HMRC (via a registration process) that an umbrella company is considered to be tax compliant in respect of all tax heads – not least as we would not necessarily expect the members of staff at an employment business or end client to be sufficiently tax knowledgeable to check the tax compliance across all tax heads of another business.
- 5.18 ***Question 14: What evidence would you expect would need to be retained, and for how long, to demonstrate that a due diligence requirement has been met?***
- 5.19 The evidence to be retained would depend on the obligation imposed (see above). As regards how long this evidence should be retained, we would suggest matching it to existing requirements to maintain PAYE records (ie 3 years in addition to the current year).
- 5.20 ***Question 15: How could a mandatory due diligence requirement be designed to ensure that compliance burdens remain proportionate?***
- 5.21 See our comments in response to Questions 9 and 12.
- 5.22 ***Question 16: What would be the appropriate level of penalty to ensure that the requirement is complied with and how should it be calculated?***
- 5.23 We would recommend that any penalty regime for due diligence failures be consistent with existing penalty regimes, for example the existing failure to maintain records penalty (TMA 1970, section 12B). While the regime could be based on the tax lost it would seem unfair that one party's liability would be based on another party's failures. Also, there would need to be provisions to take account the actions taken to prevent any loss of taxes, what the relevant party has done to mitigate potential tax lost as a result of becoming aware of their due diligence failures, the length of time that failure occurred over, and whether the failure was careless or negligent or deliberate etc. In addition, there should be a soft landing for penalties, with for example more relaxed penalties for the first year or two.
- 5.24 ***Question 17: What safeguards, if any, do you think would be required were a due diligence requirement to be introduced?***
- 5.25 There should be clear guidance on the requirements and an appealable defence that the relevant party took reasonable care/met the requirements for due diligence, plus mitigation for actions subsequently taken to address the failures (eg suspended penalties for a first offence), so that the penalty can be kept in perspective and judged fairly.

- 5.26 **Question 18: What impacts would this option have on the labour market and on the umbrella company market specifically?**
- 5.27 Ideally, this option should have little impact on the labour market as a whole but would hopefully both raise standards and diminish the current issues with tax non-compliance by retaining the good umbrella companies and driving out the bad ones. But we think this will only be so if any due diligence requirement is proportionate and that any penalties can be mitigated by showing reasonable care so that inadvertent errors are not penalised.
- 5.28 **Question 19: Would this measure lead users and suppliers of temporary labour to move away from the umbrella company model of engagement? If so, how would end clients and employment businesses engage workers instead?**
- 5.29 This would depend on the due diligence obligations. As noted above, provided the requirements do no more than codify current best practice, and the penalty regime is fair and proportionate, then we would not expect a significant change. However, if transfer of tax debt provisions are introduced (as proposed by Option 2) then this may cause less use of umbrella companies as the risks to employment businesses and their clients may be perceived as being too high.
- 5.30 **Question 20: Do you have any other comments on the proposal to require a mandatory minimum level of due diligence checks upon umbrella company engagements? In particular, are there any further risks that the government should consider before deciding whether to take this option forward?**
- 5.31 None.
- 5.32 **Option 2: Transfer of tax debt that cannot be collected from an umbrella company to another party in the supply chain.**
- Under this option the government would legislate to give HMRC the power to transfer an umbrella company's tax debt to another party in the labour supply chain, in circumstances where this debt cannot be collected from the umbrella company itself.
- 5.33 **Question 21: Do you agree that, were this option to be pursued, it would address tax non-compliance in the umbrella company market, and to what extent?**
- 5.34 In and of itself a transfer of tax debt provision would not stop non-compliance by an umbrella company. What it would do is, at best, require the end client and employment business to assure itself that the umbrella company is diligently complying with its tax obligations. More likely, we think that this option would cause employment businesses and their clients to have second thoughts about using umbrella companies, as they can't know for certain that the umbrella company is not a 'bad egg' with the result that they could be on the line for significant amounts of PAYE/NIC if there is a compliance failure.
- 5.35 **Question 22: Would this option improve outcomes for workers engaged via umbrella companies?**
- 5.36 This option would reduce the threat that a worker engaged via an umbrella company might be liable for their own income tax and NICs due to a compliance failure by the umbrella company. From that viewpoint the option would improve the outcome for workers. However, the very outcome by which workers' income tax and NICs may be borne by, say, an end-client is the concern which might drive that end client away from the umbrella company model. Another approach would be to enable HMRC to be able more effectively to pursue the umbrella company itself, ie to require it to be incorporated and managed in the UK, for its directors to be

UK resident, for transfer of tax debt provisions to apply to the owners, directors etc. In any event clearly transfer of tax debt will not assist in terms of enforcing worker's employment rights.

- 5.37 **Question 23: In what circumstances do you think HMRC should be able to transfer an umbrella company's tax debt?**
- 5.38 In principle, we do not think one party should be responsible for another party's tax debt, especially where the first party has no control over whether the second party meets its tax obligations. While a parallel might be drawn with the existing legislation at ITEPA 2003, section 688AA that permits a transfer of tax debt for Off-Payroll Working (OPW) purposes, we are concerned that such provisions often do not interact well with provisions for time limits, claims, conduct of litigation, access to confidential material regarding another taxpayer etc. If a transfer of tax debt provision is to be introduced in respect of umbrella companies, we would suggest this should only be possible where the client/employment business has not taken reasonable care. HMRC should also provide guidance/examples on what this means in a due diligence context.
- 5.39 **Question 24: Do you agree that the tax debt should be transferred to the employment business which supplies workers to the end client, with transfer also possible to the end client in certain circumstances**
- 5.40 We think that HMRC's first target for an umbrella company' tax non-compliance should be the owners and directors of the umbrella company, and any associates of the umbrella company. We consider that these persons and individuals should be personally liable for the umbrella companies tax liabilities where there has been deliberate non-compliance. Only where it is not possible to collect the tax debt from those that facilitated the failure to account for tax correctly do we think it would be appropriate for the debt to be transferred to the employment business or end client – and only then where the end client/employment business has not taken reasonable care in respect of its dealings with the umbrella company. In this regard, mechanisms will need to be put into place to apportion the debt where an umbrella company has dealings with more than one employment business/end client.
- 5.41 **Question 25: What processes would employment businesses and end clients use to identify tax risks within their labour supply chains?**
- 5.42 See our response to Question 12 above.
- 5.43 **Question 26: Do you agree that this option should apply to employment taxes as set out above [that is, income tax and employees NICs, and employers NICs]? Which other taxes could or should it apply to?**
- 5.44 We agree that if any transfer of tax debt provisions are introduced they should solely apply to the employment taxes that would have been accounted for by the employment business or end-client had the worker been an agency worker or direct hire of that business. Such taxes relate directly to the labour that the umbrella company provides in these circumstances. We do not think it would be appropriate for any other taxes to become the liability of another party.
- 5.45 **Question 27: How should the government define the engagements to which this option would apply?**
- 5.46 This should flow from defining umbrella companies (as proposed in Chapter 3 of the consultation document) and the contractual arrangements between the end client, the employment business and the umbrella company.

- 5.47 **Question 28: What steps should businesses using umbrella companies take to assure themselves that they are engaging with a compliant umbrella company? How could the government support businesses to minimise the impact of these actions?**
- 5.48 See our response to Question 12 above.
- 5.49 **Question 29: Would businesses stop using umbrella companies as a result of the introduction of a transfer of debt? How many businesses would do this and what wider impacts would there be?**
- 5.50 See our response to Question 21 above. We might anticipate a similar response from businesses as arose in respect of engaging workers through a Personal Service Company (PSC) when the Off-Payroll Working rules were introduced. This led numbers of businesses to move away from the use of PSCs in the supply chain, and indeed towards the use of umbrellas. At the moment it is not clear what might take the place of umbrellas, but possibly a move back to the use of agency workers and direct employment (which may be no bad thing).
- 5.51 **Question 30: What safeguards, if any, do you think should be included if this option is taken forward?**
- 5.52 See our response to Question 23 above. It is imperative that businesses should not face a transfer of tax debt if they have taken reasonable steps to assure themselves that they are dealing with a compliant umbrella company that, ultimately, fails to meet its tax obligations.
- 5.53 **Question 31: Would this option change behaviour of businesses using umbrella companies in the way that the government expects?**
- 5.54 Yes, as noted above, businesses will need to conduct effective due diligence checks on the umbrella company to protect themselves from any liability to PAYE/NIC that the umbrella company has not properly accounted for to HMRC. So in practice we consider that introducing Option 2 (transfer of tax debt) in effect would require business to address Option 1 (enhanced due diligence) in any event.
- 5.55 **Question 32: How likely is it that the temporary labour market would move away from using umbrella companies entirely, were this option taken forward?**
- 5.56 See our response to Questions 21 and 29 above.
- 5.57 **Question 33: Are there any further risks that the government should consider before deciding whether to take this option forward?**
- 5.58 None.
- 5.59 **Option 3: Deeming the employment business which supplies the worker to the end client to be the employer for tax purposes where the worker is employed by an umbrella company, moving the responsibility to operate PAYE.**
- Under this option a party sitting above the umbrella company in the labour supply chain (such as the employment business) would be required to make deductions of Income Tax and NICs from the fee paid for the supply of the worker's services.
- 5.60 **Question 34: Do you agree that, were this option to be pursued, it would address tax non-compliance in the umbrella company market, and to what extent?**
- 5.61 We believe that prima facie the entity employing an employee should be liable for the PAYE/NICs and not some third party as this tends to confuse the position. This said, if Option 3 was adopted, ie with the

responsibility for accounting for PAYE/NIC moving to the employment business (a regulated business), we think it would be likely to address tax non-compliance in the umbrella company market. So for this reason we think this approach does merit further consideration, notwithstanding that it moves away from the normal position where an employer is responsible for the PAYE/NIC on payments to its employees. (We are not aware of any issues with tax non-compliance by employment businesses under the agency workers legislation and this option, in effect, imposes the same PAYE/NICs obligations on the employment business as that legislation does.)

5.62 **Question 35: Were this option to be taken forward, which entity in the labour supply chain would be best placed to be the deemed employer, and why?**

5.63 We would suggest taking a similar approach as applies under the Off-Payroll Working rules such that the employment business that contracts with the umbrella company is the deemed employer. This is because we understand that this employment business will often have a close relationship with the umbrella company, eg with the employment business essentially regarding the umbrella as their 'outsourced employer'. The alternative would be, as proposed in the consultation document at paragraph 4.40, the obligation falling on the employment business that directly contracts with the end client, which is how the agency workers legislation works. But in this case the employment business may be more remote from the umbrella company which we think would be less helpful.

5.64 **Question 36: How would businesses manage their obligations as deemed employers following this change? What could the government do to support them with these new obligations?**

5.65 The relevant employment business would need to ensure that it accounts for the PAYE/RTI (or engages a payroll bureau to do this work for it) before paying the umbrella company. The employment business would need to file the PAYE real time information (RTI) reports to HMRC as if it were the actual employer (in a similar manner as applies under the Off-Payroll Working rules).

5.66 **Question 37: Would businesses stop using umbrella companies as a result of this change? How many businesses would do this and what wider impacts would there be?**

5.67 This is a difficult question to answer. But possibly not as (a) it should make no difference to the amount of PAYE/NIC to be accounted for or the administration involved (just who is doing it – and even then the employment business may outsource this back to the umbrella, ie using it as a payroll bureaux) and (b) the position as regards who the employer is for employment law purposes would remain unchanged.

5.68 **Question 38: How would the temporary labour market respond to this option being taken forward?**

5.69 Again, this is a difficult question to answer. From a worker's perspective a positive response is likely as the responsibility for accounting for their PAYE/NIC has moved to a regulated business (the employment business). Similarly, for the end client there would be greater assurance that a regulated business is correctly dealing with the PAYE/NIC of the worker, which reduces reputational risks to them and makes their due diligence easier.

5.70 **Question 39: Would this option improve outcomes for workers engaged via umbrella companies?**

5.71 Yes, as noted above in response to Question 38, with the employment business accounting for PAYE/NICs they are likely to have greater peace of mind that the correct taxes are being paid.

- 5.72 **Question 40: Are there any further risks that the government should consider before deciding whether to take this option forward?**
- 5.73 None, so long as the government is confident that the employment businesses will be tax compliant. And given that they are regulated we do think this is an option which should be examined further.
- 5.74 **Question 41: Are there any other options that have not been covered in this chapter that you think could reduce non-compliance in the umbrella company market?**
- 5.75 Yes, see our comments at paragraphs 5.6, 5.7, 5.15, and 5.40. In addition, we note that the majority of recent Promoters of Tax Avoidance Schemes (POTAS) Stop Notices published by HMRC relate to contractor schemes operated through an umbrella company. However, any names on the Stop Notice publication list<sup>4</sup> only remain there for twelve months. Considering the history of phoenixism in the sector, we suggest consideration is given to extending the time the names remain in the public arena after a Stop Notice and that greater publicity is given to those named.

## 6 Targeted options to address tax non-compliance

- 6.1 The government proposes targeted changes to tax legislation to address the abuse of specific tax reliefs by some umbrella companies. These reliefs are the employment allowance and the VAT flat rate scheme, whereby mini-umbrella companies (MUCs) are created so as to qualify for employer's NIC relief (employment allowance) and, effectively, a reduced VAT liability.
- 6.2 **Questions about the VAT flat rate scheme and MUC abuse**
- Question 42: What more could HMRC do to prevent abuse of the scheme? Are there any specific options that you believe the government should consider?**
- 6.3 See our responses to Questions 38 and 41 above. HMRC could also require the umbrella company to apply for permission to use the flat rate scheme, instigate checks when the first return(s) is received, and deregister them from the scheme as necessary.
- 6.4 **Question 43: What benefits does the scheme currently provide when compared to other accounting simplification measures (eg 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**
- 6.5 No comments.
- 6.6 **Question 44: What effect, if any, has the 'limited cost' test had on your VAT accounting obligations?**
- 6.7 No comments.
- 6.8 **Question 45: Do you have any other thoughts you would like to share on the VAT flat rate scheme?**
- 6.9 One option might be to remove the flat rate scheme or prevent umbrella companies from using the scheme.
- 6.10 **Questions about the employment allowance option**

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<sup>4</sup> [Named tax avoidance schemes, promoters, enablers and suppliers - GOV.UK \(www.gov.uk\)](https://www.gov.uk)

**Question 46: Do stakeholders agree, that if this option were implemented (ie the requirement for a UK resident director), it would help address abuse of the employment allowance?**

- 6.11 As suggested above at paragraph 5.15, rather than requiring at least one UK based director, umbrella companies could be required to be incorporated, managed and controlled in the UK.
- 6.12 We do not believe that requiring one UK based director on its own would necessarily prevent the abuse of the employment allowance. This is not least because we are aware that sometimes UK-based individuals are duped into acting as directors by unscrupulous operators in return for what they see as a relatively attractive fee for relatively little work. But requiring UK directors (one, or as we suggest above, potentially all) and UK management and control etc, would nevertheless be a clear 'signal of intent' by HMRC. If backed up with publicity aimed at preventing innocents being scammed into becoming directors of mini umbrella companies (MUCs), and a requirement that newly appointed directors are given information about their responsibilities as a director (and the consequences if a company fails to meet its obligations, is involved in fraud, etc) this could form part of the solution to tackling this fraud.
- 6.13 **Question 47: Are there any ways in which mini umbrella companies could sidestep these changes, and if so, how could this proposal be strengthened to reduce or prevent this risk?**
- 6.14 We have to recognise that for those determined on non-compliance a requirement for one (or more) directors to be UK resident could be sidestepped. For example, having an address in the UK does not necessarily mean that an individual is resident in the UK, or the director may have been UK resident at the time of their appointment but could subsequently leave the UK and become non-UK resident. (We understand that MUCs are often set up with UK resident nominee directors who are then replaced by non UK resident directors.) If backed up with active checks and rechecks on the residency status of the director(s), active and publicised enforcement where fraud is attempted, then the proposed changes could form part of the answer to reducing MUC fraud.
- 6.15 Another approach might be to require umbrella companies to apply to HMRC for permission to claim the employment allowance, that way their eligibility can be checked and monitored, and appropriate action taken as necessary.
- 6.16 **Question 48: For limited companies, how would your business be impacted if eligibility requirements were brought in that required your business to have at least one UK director in order to claim or continue claiming the employment allowance?**
- 6.17 No comments.
- 6.18 **Question 49: Would there be any barriers to appointing a UK director for those legitimate businesses who do not currently have one in place but who are eligible to claim the employment allowance?**
- 6.19 No comments.
- 6.20 **Question 50: Are there any wider benefits, impacts or risks involved with this proposal that have not been identified above?**
- 6.21 See paragraph 6.12 above.
- 6.22 **Question 51: Do stakeholders consider it would be beneficial to amend payroll software to make explicit that a UK director is required at the point of claiming the employment allowance?**

- 6.23 We are unclear how, on its own, this would prevent fraud. If an umbrella company provider is intent on umbrella fraud they will simply lie on their RTI submissions. Such a requirement would need to be backed-up with active checks and rechecks by HMRC to ensure that there was and remains entitlement to the employment allowance.
- 6.24 ***Question 52: Aside from the proposed option and wider options discussed throughout this consultation, what more could HMRC do to reduce the abuse of employment allowance?***
- 6.25 See our responses to Questions 9, 12, 38, 41, 42 and 46.

## **7 Acknowledgement of submission**

- 7.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

5 September 2023