

FCSA Response to follow up questions from Ruth Cadbury MP, Co-Chair of the Loan Charge APPG

Please find below the FCSA responses to the Loan Charge APPG further questions:

How many umbrella companies do you believe are currently operating and of these, how many (numbers or proportion) are FCSA members and how many are not? We are trying to get a clear picture on just how many umbrella companies are in operation and what proportion are FCSA members.

FCSA established 12 years ago to address the fact that there was no compliance standard in the sector meaning that the supply chain and contractors had no visible means of assuring themselves that they were dealing with compliant outsourcing companies. The FCSA began with 5 companies and today there are 65 members who in turn employ 170,000 contractors.

Around six years ago there were circa 400 umbrella companies operating in the UK, but two factors have driven this number up. There is a general trend for end users to de-risk in terms of fixed costs to their business which has resulted in a decrease in traditional employee bases to a mix of permanent staff and freelance contractors which allows companies to manage their demand cycles and the costs that apply to that demand.

More, recently IR35 reforms have caused a surge in former single director limited companies to move across to umbrella employment resulting in increased demand for umbrella services in the supply chain. As a result, we now estimate that there are closer to 800/900 umbrella companies. We cannot be exact because many companies operate under the radar and or liquidate quickly and then reform. This is the growing criminal element of the sector.

And whilst some companies are extremely clever at purporting to be UK based, their operations are often based in the Isle of Man, Cyprus or India with very convincing shop front websites that may indicate UK establishment.

We have been told that some recruitment agencies specify which umbrella companies' clients (contractors/freelancers) must use, as part of offering work. a. Is this something that the FCSA is aware of?

b. What if any advice has the FCSA given to members on this issue?

Yes, this is common practice and the FCSA is aware of this practice. But this is supply chain driven and in present circumstances and with little or no legislation around this issue there is little that FCSA members can do to address this. Both umbrella companies and contractors can only react to the supply chain dynamics which are often dictated to them.

As an example:

Large logistics company will go out to tender to for the supply of:

- a) 100 IT contractors for a 6-month major change project
- b) 600 packing contractors to work in its warehouses on a constant rolling basis.
- c) 10 management consultants to manage the delivery of the IT project mentioned above.

They will award 3 exclusive contracts to three recruitment agencies (often through a third-party managed service company). Those recruitment agencies will already have a preferred supplier list (PSL) of umbrella companies and so they will only do business with those companies identified on the PSL.

Umbrella company A is awarded contract a) and c) above whilst umbrella company B is awarded contract c)

The contractor enters this arrangement at two points; they are either already employed by one of the umbrella firms or apply to the agency advertising the vacancy at which point the agency insists that they register with one of the PSL umbrella companies to qualify for the vacancy.

As a result, the contractor will terminate their relationship with their current umbrella employer and switch to one of the companies above. This dynamic means that the average umbrella company must replace their contractor numbers circa every six months.

There is little advice that FCSA can give its members on this as they, like contractors are at the mercy of the decisions made at the very top of the supply chain.

We have been sent written evidence that states that some umbrella companies make payments (described by some as 'kickback payments' to recruitment agencies as part of their agreement to tell their clients to use that umbrella. a. Is this something that the FCSA is aware of?

b. Is it something that any FCSA members have done or do, that you know?

c. What if any advice has the FCSA given to members on this issue?

FCSA does not in any way approve of this practice but it is a common element within the supply chain (and in other sectors) and again is driven by the supply chain, with umbrella companies always at the bottom of that chain and so are often given a 'take it or leave it' option.

Simple cash incentives are difficult to hide in this era as HMRC are likely to see unaccounted cash leaving a business with no destination and so incentive schemes involve non-cash alternatives.

Common incentive/kickback schemes include:

- Time sheet rebates – for every time sheet an agency provides to an umbrella a small rebate is applied (unofficially) of say £10 which of course boosts the agencies profit margin whilst decreasing the umbrella margin.
- Some agency directors will insist on incentives such as new kitchens or paid for luxury holidays or indeed pre-paid credit cards. The message to the umbrella being ‘pay or you don’t get our business’.
- Another common and legitimate incentive is the agencies requirement for umbrella companies to pay a fee to be included on the PSL. Fees of £30,000 are not uncommon but because it is generally publicly stated then of course the income/outgoing is declared to HMRC.

FCSA members work to a strict code of compliance which means that they adhere to ALL employment and financial regulations set down by UK law. And that in turn means that a compliant umbrella carries more legitimate costs. Thus, a fully compliant umbrella company will always operate on low profit margins. The umbrella sector is a high volume, low margin business model.

And so, non-compliant umbrellas save costs by failing to take on employment costs, failing to pay holiday pay, taxes, NI, pension contributions, apprenticeship levy etc. This gives them a huge profit margin which allows them to fuel the incentive schemes within the industry.

Because FCSA members carry large legitimate costs they are the ones that can ill afford to take part in these schemes and so lose business as a result. FCSA members will often publicly state to potential supply chain partners that they will not participate in such schemes and so lose business as a result.

FCSA members do participate in the third element of schemes highlighted and our codes allow this if it is declared by both parties. The FCSA are not aware of any FCSA members taking part in the first two examples and do not approve of those schemes. But we are aware that members do come under extreme pressure to do so. With low margins, no compliant umbrella wants to willingly participate in these schemes.

We have been sent written evidence that states that some umbrella companies routinely withhold holiday pay from contractors, so we wish to know:

a. Is this something the FCSA is aware of?

b. What if any advice has the FCSA given to members on this issue?

c. Is it something that any FCSA members have done or do, that you know?

d. What if any advice has the FCSA given to members on this issue?

e. Has the FCSA taken any action against any members for doing this?

This is a very common scam that exists within the sector. Our detailed codes of compliance make it very clear that holiday pay must be calculated and attributed in line with current legislation.

Contractors are entitled by law to either take actual holiday (again, our codes insist that this is encouraged to ensure the health of the contractor) or accrue it and take it as payment at the end of assignments/employment.

Whilst the FCSA has expelled FCSA for non-compliant practices, I am not aware of any members being expelled for withholding holiday pay. However, if we were provided with evidence and the contractor had exhausted the umbrella appeal process then we would investigate and if necessary, expel the member.

Each member is audited every year and as part of that audit they must declare whether any of the directors have been subject to prosecution or investigation by HMRC. If they do declare this then the FCSA perform their own investigation. However, this is an area where we would encourage HMRC to inform us directly so that we can further assure ourselves of fully compliant behaviour.

We have been sent evidence that indicates that some umbrella companies have been litigated against together with agencies for unlawful deductions of national insurance contributions and/or holiday pay, and that the companies have settled out of court. So, we wish to know:

a. Is this something FCSA is aware of?

b. Is it something that has happened with any FCSA members?

c. Are FCSA members required to report any litigation like this to the FCSA?

d. Are FCSA members required to report any such out of court settlements to the FCSA?

e. Has the FCSA taken any action against any members that have been involved with such out of court settlements.

Non-compliant umbrella companies make huge sums of money by offering 80% plus take-home pay. This is impossible if the umbrella company is compliant. Contractors are becoming increasingly desperate (because of changing family income pressures etc.) and are choosing to ignore the boring fact that depending on your tax code you will only take home between 50 – 65% of your gross pay.

Criminal elements are exploiting this with offers of loan schemes, tax efficient trusts and by banking tax, NI and pension contributions that are payable, on behalf of the contractor, to HMRC. This is an element that the contractor is often unaware of until the tax man comes calling circa two years down the line. By this time, the umbrella has usually liquidated, and the directors are operating a similar scheme under a new brand.

If the FCSA becomes aware of such practices it takes immediate action. Several non-compliant companies attempt to gain membership to give them a legitimate front to operate from. Our due diligence tests for membership are rigorous and as a result we reject 70% of companies applying for membership (hence we only have 65 members).

In January of this year the FCSA were given evidence that a member was failing to pay both tax and NI on behalf of a contractor working within the healthcare sector. They were immediately suspended and have just been expelled. They have 14 days to remove any suggestion that they are an FCSA member from their publicity materiel. If they do not, we will identify them on our own website. As a matter of course, we will then provide our materiel to HMRC.

We have a very high retention rate and members demonstrate every year that they are operating compliantly, so this occurrence is rare, but we have in the past expelled members for non-compliant behaviour and will continue to do so.

We have been sent written evidence that states that some umbrella companies have specified that their employees/clients must agree to waive holiday pay to receive furlough payments, during the Covid-19 pandemic. a. Is this something the FCSA is aware of?

b. What if any advice has the FCSA given to members on this issue?

c. Is it something that any FCSA members have done or do, that you know?

d. What if any advice has the FCSA given to members on this issue?

e. Has the FCSA taken any action against any members for doing this?

The FCSA has given comprehensive advice to members on the furlough scheme but this has simply been the supply of Government releases and amendments which of course includes the Government guidance on entitlements within the scheme, including holiday pay.

The FCSA is not aware of any member who is not following Government guidance. However, we should stress that some of the guidance has been misleading in some instances and HMRC guidance has been slow to catch up on specifics and so it will be unsurprising if members and companies in general make decisions which will later be interpreted as errors.

May FCSA take this opportunity to make two points:

As an organisation that exists to promote ethical and compliant behaviour in the sector our website makes freely available a range of guides and tools to assist the industry (including contractors) outside of the FCSA to be compliant. Our latest guide is for agencies and contractors to enable them to identify compliant umbrella companies and illegal ones. Please find a link to them here: <https://www.fcsa.org.uk/a-guide-to-compliant-umbrella-companies/>

Within this link is a guide to non-compliant umbrella companies.

Finally, the FCSA have been working with BEIS and Matthew Taylor to help bring about regulation of the sector. We are concerned that he has not been replaced and that the primary legislation bill is still to be given Parliamentary time.

Ideally, we would have liked to see IR35 reforms consider many of the amendments set out in the House of Lords Finance Committee recommendations and for IR35 reforms to be timed so that they came into force after regulation had been passed so that both could act as a 'good agent' in helping the FCSA efforts to reform the sector so that an ever-increasing freelance population can be properly protected.

The reality now is that IR35 reforms alone are creating an expanding market for non-compliant (often offshore) operators who are exploiting contract workers at an alarmingly increasing rate, especially within the healthcare sector, which has seen an influx of contingent workers coming back to the NHS to help with the pressures of the pandemic.

FCSA is the voice of compliance within the sector and will assist the Loan Charge APPG in any area it can.

Phil Pluck

CEO
Freelance and Contractors Services Association

