Loan Charge and Taxpayer Fairness
All Party Parliamentary Group

Response to HM Treasury consultation
'Tackling non-compliance
in the umbrella company market'

August 2023

This Report was researched and written by the Loan Charge APPG. The Loan Charge APPG Secretariat is staffed and funded by the Loan Charge Action Group.

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1. Introduction

This is the response to HM Treasury's open consultation 'Tackling non-compliance in the umbrella company market' HM Treasury Consultation, from the Loan Charge and Taxpayer Fairness APPG.

We are sending this in place of a response to the online consultation. The online questionnaire is very specific, in some places asking technical questions (many of which the APPG itself would not have a view on).

Our overall view remains very strongly that the Government must act and do so clearly and decisively to stamp out the abusive practices that are all too common in the umbrella company sector and also to stop rogue umbrella companies from facilitating tax avoidance schemes.

We again remind the government of the report on our inquiry into 'How Contracting Should Work' and the supply chain for contract and freelance workers. The report is here. The conclusions and recommendations of this inquiry are directly relevant to the consultation and we repeat them here.

Whilst the consultation is focused on umbrella companies – and that is indeed where many of the problems and issues have been identified – the consultation also should include looking at the role played by recruitment agencies and the wider supply chain, including the relationship between recruitment agencies and umbrella companies, why and if umbrella companies are necessary or desirable at all and the key question as to whether or not they are genuine employers.

The consultation also must look at related legislation, including the flawed 'IR35' legislation or there is a danger that it will be partial and could fail to tackle the issues related to flexible workers as a whole.

2. Key issues that the Government must tackle in responding to the consultation

The 'How Contracting Should Work' inquiry and other evidence shared with the APPG has identified these current abuses and malpractice in the supply chain involving both umbrella companies and recruitment agencies:

- Recruitment agencies demanding 'kickbacks' or incentives from umbrella companies for being added to a preferred supplier list/recommended to clients, even sometimes including fitted kitchens and holidays for recruitment agency directors. This then incentivises non-compliant providers (who because of non-compliance have higher margins) to offer large bonuses to gain access to potential clients.

- Some contract, freelance and locum workers being pushed to use a specific umbrella company and in other cases being given no choice as to which umbrella company to use as a condition of employment (effectively being told 'take it or leave it'). This is a particular problem when the only

source of work in a sector is via recruitment agencies. This is the case for many workers including some lower paid contract and locum workers.

- Some public sector approved agencies and organisations recommending people use umbrella companies that put them unknowingly into 'disguised remuneration' schemes.
- A general lack of transparency over deductions, fees and contractor pay/payments and some recruitment agencies ignoring the legal requirement to provide all workers with a Key Information Document (KID).
- Some umbrella companies appearing to unlawfully deduct employer's taxes from contractors' pay.
- The covert withholding of holiday pay by some umbrella companies because the contractor did not know it was claimable. In some cases, this has also involved umbrella companies refusing to pay Covid furlough unless contractors waived their right to holiday pay.
- Contractors are being made to Opt-out of the Conduct of Employment Regulations when they work via an umbrella, so that the agency circumvents giving the contractor rights, one of which is that they do not have to be paid unless the agency gets paid. Opting out should (by law) be an informed choice, but in reality, contractors who complain report suddenly find the job no longer exists. It is deeply troubling that workers are being pushed to opt-out of rights that Parliament intended for them, simply to benefit recruitment agencies.

3. The wider supply chain – the role of recruitment agencies and end clients

The current consultation would be partial and fail to deliver its objectives if it focuses only on umbrella companies and ignored the close relationship and practices they have with recruitment agencies.

As above, non-compliance is fuelled by agencies demanding money for access to market which umbrellas companies have to agree or they don't get workers and business.

The 'kickbacks' are funded in several ways. The agency quotes an 'assignment rate', and not a Pay As You Earn (PAYE) rate. 'Skimming' happens as the umbrella takes money it should not from this amount, before it is paid to the contractor/worker. This is an example of how flexible workers are exploited in a way that permanent workers are not. Agencies are not permitted to advertise permanent workers roles in this way yet are not banned from doing so for contractors and temporary roles. This does not make sense and it opens the door to abuse. If instead agencies were forced to quote rates for workers as either gross ('outside IR35') or PAYE (not 'outside IR35'), then this practice would not arise.

As a result of the money they demand and receive from umbrella companies, recruitment agencies often make it a condition of work that the workers use a recommended umbrella company when they could instead operate their own payroll or use a payroll bureau to do so. This is also linked to IR35 determinations where agencies often say that the worker is 'inside IR35' and must therefore use an umbrella company. This can lead to the called the so-called 'Gross Payment Model' which must be outlawed.

Payments of any kind from a payment intermediary to an agency must be made unlawful, this is hugely important.

No workers should be obliged to use an umbrella company and it must be made unlawful to insist on the use of umbrella companies. Workers should always be given a choice, and agencies can and should offer a payroll for temporary workers.

A key issue that the Government must resolve as part of these reforms is who the employer is within the convoluted supply chain. This comes down to who provides the supervision, direction and control. Umbrella companies are claimed to be the employer of flexible workers, yet in reality often do not appear to have supervision, direction and control, which often lies with the end client (which doesn't want to employ the worker directly, to save on employer taxes and to avoid having the responsibility of employment). If an umbrella company is merely acting as a payroll (which is because the recruitment agency doesn't want to do this, rather than because it is a benefit to the worker) then it cannot credibly be argued to be an employer. The employer therefore must be either the recruitment agency or the end client. This lack of clarity (and indeed the unnecessarily complex supply chain) is a key cause of the Loan Charge scandal.

It appears that the Treasury consultation assumes that umbrella companies are the employers of the workers on their books, however this assumption needs challenging. The consultation must look at the role of recruitment agencies and end clients and not merely umbrella companies and must take heed on the question of whether flexible workers are employed or self-employed and provide certainty about this with applicable rights and benefits.

It is also time for end clients to be made responsible for debt transfer provisions so they enforce their own checks to ensure compliance. The consultation has presented three options, the easiest of which to implement is debt transfer, where the agency and/or their directors are liable for the tax if the umbrella does not pay the correct amount. This one simple measure would solve many of the issues.

The debt transfer provisions should apply to the end client because sometimes clients do not use agencies but an umbrella company is used simply so the client company can avoid paying employment taxes and having employer responsibilities. In these cases, the umbrella appears to be a sham employer. The only exception would be if there are associated companies in the same group, otherwise there can be no justification of this.

In many instances it is likely to lead to an agency moving the payroll in-house. There are many providers, some who offer umbrella, that can provide an in house service, for less than the cost of an umbrella or an external payroll function/bureau can be used (which is not an umbrella company nor performing any role other than payroll). If this happened, kickbacks would stop.

Debt Transfer would be the catalyst that solves a considerable number of the problems, and as the HMRC non-compliance list shows, HMRC do not have the resources to catch the operators early enough, often taking years before the operator goes on the list.

4. The context of IR35 legislation and the lack of clarity for flexible workers

In our 2019 report we concluded that:

- **'IR35'/off-payroll legislation has been a clear driver in the proliferation and use of unregulated umbrella companies and related arrangements** (some of which have then involved 'disguised remuneration' schemes).
- **The lack of a single, approved model of working is a fundamental problem that causes uncertainty, prompts fear of HMRC action and has been a driver of tax avoidance schemes.**
- **The proliferation of 'disguised remuneration'/tax avoidance schemes has been driven by a number of key factors, all of which need to be addressed (as such schemes are *still* being mis-sold)**:
    - The lack of a clear and approved way of working for contractors, which has been made significantly worse by the 'IR35' legislation and the off-payroll working rules.
    - Some (non-compliant) umbrella companies/payment intermediaries facilitate and actively promote tax avoidance schemes to contractors.

Those conclusions have been demonstrated to be quite correct, following the implementation of the 2021 off-payroll rules roll-out.

The Treasury and HMRC should therefore accept the clear and demonstrable role that the so-called 'IR35' legislation has had in the proliferation and use of unregulated umbrella companies and related arrangements, some of which have then involved 'disguised remuneration' schemes. We welcome the fact that the Government intends to take to action to deal with part of this, namely umbrella companies and pleased that it appears that the APPG report and other evidence has been taken note of. However there also

needs to be action beyond umbrella companies, to address other issues in the supply chain, but also wider legislative changes that create tax certainty for freelance workers which are appropriate and fair.

5. Measures to tackle tax avoidance

Amongst the biggest concerns in the sector is the way that some umbrella companies have been complicit and in some cases directly involved in the recommendation and proliferation of what HMRC calls 'disguised remuneration' schemes. With the APPG's remit of concern over the Loan Charge and overall taxpayer fairness, this is a particular area of concern regarding the supply chain, including umbrella companies, and something we have long called for more meaningful action over.

Much has been made of HMRC 'naming' promoters and issuing Stop Notices. However the impact of these measures is limited (and flawed) and they will not stop the ongoing promotion and mis-selling of tax avoidance schemes by unscrupulous operators.

Under the Finance Act 2021, HMRC publicly names schemes, however these are only added for a year, then removed, which is weak but also confusing, as does this then signify that these schemes are acceptable? In any case, simply publicly naming schemes and operators does nothing to deal with the fact that these schemes have been operational for some time and that there will have been people who were mis-sold them as legal and compliant and will face unexpected HMRC demands as a result. Often firms don't get on the list until years after they have started operating, by which time many victims have been created, and HMRC then issue the victims with tax bills.

The only meaningful action is to stop schemes operating in the first place or at least as soon as they become operational. HMRC have the data to prevent this happening, but fail to do so. They need to upgrade their detection systems and put resource into doing what is really needed, to stop schemes as they start.

With regard to the proposal for HMRC to issue Stop Notices, this is also limited and weak in practice. Any promoter in receipt of a Stop Notice will of course stop that particular scheme, dissolve associated companies and disappear (as has been a common pattern) often leaving those who have already been mis-sold the schemes are being even more vulnerable. As HMRC cannot (under current legislation) go after the promoter, all liability falls on the scheme users. In addition, a Stop Notice makes it unlawful for a person subject to the notice to continue to promote the scheme subject to the notice *only*, but not to promote different schemes, which is a huge loophole that unscrupulous promoters can exploit.

What the Government and HMRC should of be doing is to stop the schemes in the first place before they dupe people into using them and later being hit with unexpected and unaffordable bills. That is the only action which is meaningful. HMRC have a dreadful record of failure in that regard of failing to shut down schemes, failing to warn people and even signing off years of tax returns without raising any issue.

HMRC receives Real Time Information data that allows it to identify suspected tax avoidance schemes very quickly yet does not currently use the data it has. HMRC must properly link and reconcile the quarterly data of employment intermediaries with the Real Time Information (RTI) submissions to quickly detect tax avoidance schemes and then take action to shut them down.

The simple reality is that no promoter has been charged, never mind prosecuted, for promoting these schemes, nor is HMRC asking them to pay a single penny of the disputed tax, despite them making very significant amount of money from doing so. One of the biggest injustices of the Loan Charge Scandal is that HMRC is demanding maximum tax from those who were mis-sold schemes, whilst those who mis-sold and operated the schemes have been allowed to retain all the fees they charged for what they had assured clients were legal and compliant arrangements. This must change and doing so would make it too risky to promote and operate schemes in the first place.

We therefore also wish to see consideration of an overriding principle that where someone has been sold something as legal, legitimate and compliant, then any tax deemed avoided becomes the liability of the scheme promoter operator (or at least that any fees paid would be recoverable to offset tax due). We believe this would stamp out schemes overnight by putting the risk onto the promoter/operator, rather than the current situation, where they know that HMRC will simply pursue the scheme user, even where they are the victim of mis-selling.

We therefore believe the law should be changed to make recruitment agencies/umbrella companies/payment intermediaries and their directors liable for taxes later deemed to have been avoided or not paid if a scheme is designated a tax avoidance scheme.

6. The agency provisions

One of the many troubling aspects of the Loan Charge Scandal is that HMRC persuaded Government to introduce the draconian retrospective Loan Charge, when it had failed to deal with the issue of scheme operation at the time, failed to inform users and in many cases signing off tax returns without raising enquiries. Part of the failure is that HMRC failed to do its duty under the agency rules, in section 44 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) which obliges HMRC to collect Pay-As-You-Earn tax (PAYE) from whomever is deemed to be the employer, often recruitment agencies. HMRC has admitted in their recent discovery assessment letters that employers are liable, but there was a chronic failure to collect this at the time.

One important question with regards to the current consultation is why HMRC needs further powers to collect PAYE at source when it appears to already have these powers (and indeed this duty).

If new powers were introduced, what is to say that HMRC would use them, having systematically failed to use them regarding the schemes now subject to the Loan Charge? Had HMRC done their duty and enforced the agency provisions, then the Loan Charge Scandal would never have happened. Lessons therefore must be learnt rather than this key failure being brushed under the carpet to spare HMRC's embarrassment. There still therefore needs to be a clear and honest answer from HMRC as to why they have failed to use the existing powers in section 44 of ITEPA 2003 to secure payment of PAYE in respect of contractors from employment agencies. If there is some shortcoming in the existing legislation (which is not apparent), why not amend ITEPA so that HMRC tax payment at source.

7. The lack of credible accreditation and the case for regulation

It is clear that the current system of accreditation does not stop non-compliant and rogue operators (umbrella companies/payment intermediaries and recruitment agencies) from operating tax avoidance schemes or from seeking other opportunities for malpractice.

We continue to be of the view that industry 'self-accreditation' doesn't work. We have concerns about the Freelancer and Contractor Services Association (FCSA) which refused to respond to important questions in two letters we sent them despite the issues we had raised being in the public domain. For a body that claims to offer a 'gold standard' accreditation system, it is very troubling that they refused to answer these simple and important questions about issues that have been raised by workers and others.

It has also been reported that some FCSA members have engaged in the unacceptable practices that we highlighted in our report. Recently it was reported that an FCSA member and large umbrella company has been accused of 'skimming' contractor pay.

We have also had information sent to us from smaller umbrella companies and others who believe that the FCSA operates in the interests of the large umbrella companies, not the sector as a whole.

It is also impossible, in our view, for a trade body to lobby on behalf of and claim to represent the interests of umbrella companies (and promote their use) and also run a credible accreditation system. We note that on 25th August 2023, the FCSA published an online document '10 reasons agencies should use umbrella companies'. Considering what our report unearthed about the issues of agencies and umbrella companies, it seems ill-timed that at the time of a Government consultation into umbrella companies, the FSCA is actively promoting even greater use of umbrella companies by recruitment agencies. Without reform and regulation, we do not believe this is in the interests of flexible workers.

8. Employment rights

We believe that it is unfair for workers who are taxed as employees to be denied the rights and benefits of an employee or recognition in employment law. We ask the Government to take seriously the conclusions and recommendations of the Taylor Review. In particular, the Government must take a very simple but hugely significant step in resolving all the issues and problems associated with the lack of a proper definition and clarity for contracting and freelancing. Anyone who is taxed as an employee should also receive the corresponding benefits; thus, by aligning tax and employment law, certainty for both contractors and hirers will ensue.

9. Conclusion

Action is needed which we hope will happen before the General Election next year. Legislation to stamp out malpractice and for proper oversight and regulation of the whole supply chain for flexible workers (not just umbrella companies) is needed. We believe the following measures are required to tackle the issues identified:

- To strengthen, clarify and enforce the existing regulation that makes it unlawful for an employment business to offer a position that is conditional on using an umbrella company or payment intermediary. Agencies should be obligated to offer Agency Payroll as the default choice, and not umbrella as a condition of work.
- To make it unlawful for agencies to receive financial incentives or 'kickbacks' from umbrella companies, via timesheet commissions, introductions, or otherwise.
- To make it unlawful for a contractor to be forced or coerced to opt-out of the Conduct of Employment Regulations (unless they are working on an 'outside IR35' basis via a limited company (Personal Service Company)).
- To stop agencies from offering different options at different pay rates, so stopping the so-called 'assignment rate' offered to workers.
- To make it a statutory obligation to quote only PAYE contract rates for temporary worker engagements that are not 'outside IR35' . The Key Information Document must include the full PAYE rate offered, which must be paid by the umbrella company.
- To clarify the situation regarding employer's tax and National Insurance contributions. Rates should not be allowed to be quoted that include employment taxes/costs.

- To outlaw the withholding of holiday pay whilst at the same time introducing the recommendation from the Taylor Review, allowing contractors to receive, by default, their holiday pay 'rolled up'. The way to do this is to mandate that holiday pay is paid out rolled up and cannot be accrued.
- To introduce mandatory transparency, so that all payment intermediaries and agencies must disclose all fees and costs and explain all deductions, both in documentation and on payslips.
- To ensure the debt transfer provisions apply to agencies and to end clients.
- To make those who promote and operate schemes that are deemed to be forms of tax avoidance exclusively liable for any tax avoided.
- To ensure transparency and simplicity for flexible workers. We welcome that that the Government is seeking to narrow down the options of workers are engaged, thereby stopping more convoluted ways of working (and disguised remuneration schemes) being created.
- To properly address the issues created by the IR35 off-payroll rule reforms, which far from increasing clarity, have increased the confusion over flexible/contract working as well as pushing workers into zero rights employment. The mess is even greater than it was due to the ambiguity of IR35 determinations and the complexity of how they are being made.
- To examine whether there should be certain roles in certain situations where an employer must engage fully employed permanent workers and not self-employed contractors or freelance staff where it is deemed that supervision, direction and control is only possible by the end client. One obvious role that this applies to is commercial airline pilots where the supervision, direction and control (and the equipment, the plane) can only be supplied by the airline.
- To commission a proper review into contracting and freelancing, with the aim of create clarity and certainty for all parties involved, to stamp out abusive practices and tax avoidance schemes, the Government must conduct a proper review of self-employment, which is both needed and long overdue.

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