



# **Loan Charge All-Party Parliamentary Group**

## **Inquiry on 'How Contracting Should Work'**

**April 2021**

### **Report**

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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# Summary and key recommendations

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## The Inquiry – How Contracting Should Work

This inquiry examines how contracting and freelance working should operate, be remunerated and taxed fairly and appropriately. It also looks at the factors that have led to the use of tax avoidance schemes and the changes that could be considered to discourage their use in the future. The APPG believes that this is of fundamental importance to avoiding another Loan Charge scandal and the best way ultimately to stop the promotion and use of so-called disguised remuneration schemes, as well as finally properly recognising contracting and freelancing in legislation.<sup>1</sup>

### The key findings can be summarised as follows:

- **‘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) and the Government should accept this and seek to implement legislative changes that create tax certainty for freelance workers which are appropriate and fair. We believe that the off-payroll reforms, which are now being rolled out into the private sector from April 2021, should be amended during the passage of this year’s Finance Bill and that tax law and employment law should be aligned. The direct threat of being classed as a ‘deemed employee’ is a fundamental problem for contractors/freelancers and client organisations.
- **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.** We believe that a simple, clear model should be agreed for all professional self-employed contractors and freelancers. This could be a new form of limited company, a limited liability partnership or a new freelance tax status or tax code. These are all ideas that have been suggested to this review as ways to deal with the muddle of the current situation and the ongoing and deeply problematic ‘IR35’ and subsequent off-payroll legislation and all are worthy of consideration, as part of a much-needed and long overdue overhaul.
- **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.

We call upon the Treasury and HMRC to 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. Instead of denying this reality, the Treasury should seek to implement legislative changes that create tax certainty for freelance workers which are appropriate and fair.

- **The ‘How Contracting Should Work’ Inquiry has found other significant issues with the supply chain, which has been described as the ‘Wild West’.**
  - Recruitment agencies demanding ‘kickbacks’ or incentives from umbrella companies for being added to a preferred supplier list/recommended to clients, even sometimes including fitted

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<sup>1</sup> <https://www.gov.uk/government/publications/good-work-the-taylor-review-of-modern-working-practices>

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.

- In some cases, contract, freelance and locum workers are being pushed to use a specific umbrella company and, in other cases, workers are given no choice as to which umbrella company to use, so the situation facing the worker is effectively ‘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.
  - In some instances, public sector approved agencies and even public sector organisations themselves have recommended people use umbrella companies that have put them into ‘disguised remuneration’ schemes.
  - A general lack of transparency over deduction, 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 appear to be unlawfully deducting 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.
- **It is clear that the current system of voluntary regulation and 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.**
  - **The Inquiry has discovered that 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 UK tax system is extremely complex by international standards<sup>2</sup> and this in itself is a problem that leads to confusion and in some cases exploitation of contractors and freelancers.
  - We believe that the Government should accept the reality of the complex and confusing situation involving professional contractors and freelancers, and that these are a significant driver in the proliferation of tax avoidance schemes. These workers and their advisers need clarity, as well as the establishment of statutory regulation and compliance, to drive promoters and operators of tax avoidance schemes, alongside other forms of non-compliance and malpractice, out of the market once and for all.
  - **It is clear from this Inquiry that a proper, official review of professional contracting and freelancing is both urgently needed and long overdue.** We hope that this Inquiry will lead to this crucial task being picked up by both the most appropriate Parliamentary Select Committees and Government. There are significant issues that need to be addressed to stop the ongoing proliferation of disguised remuneration and tax avoidance schemes. It remains odd that the Government has failed to act on or implement the recommendations made by the Taylor Review<sup>3</sup> that it commissioned in 2017.

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<sup>2</sup> <https://www.taxcomplexity.org/>

<sup>3</sup> <https://www.gov.uk/government/groups/employment-practices-in-the-modern-economy>

## The key recommendations are:

### A Government Review to recognise and structure professional contracting and freelancing

**Key recommendation 1:** We believe that the Government should commission a follow-up review to the Taylor Review. This could form part of the review into supporting self-employed people promised in the 2019 Conservative General Election manifesto. This should investigate the best way to structure, remunerate and tax professional contracting and freelancing. It should also look to implement a fair, transparent, regulated and workable solution.

### Align Tax Law and Employment Law

**Key recommendation 2:** We call on the Government to accept 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.

### Review and Update 'IR35' and off-payroll/Intermediaries Legislation

**Key recommendation 3:** We believe that the off-payroll reforms, which are now being rolled into the private sector from April 2021, should be looked at during the passage of this year's Finance Bill. The Treasury and HMRC should stamp out the abusive practices outlined in this report. All 'inside IR35' workers should get full rights under all legislation dealing with agency workers, with a clear and transparent right to holiday and sick pay.

### Regulate the Supply Chain – Payment Intermediaries, Umbrella Companies and Recruitment Agencies

**Key Recommendation 4:** We call on the Government to consider introducing statutory regulation for payment intermediaries. Given that the main representative bodies in the sector already agree with this, then the Government should proceed as quickly as possible to clean up the supply chain, the 'wild west', which is clearly where many of the problems associated with DR (HMRC's so-called disguised remuneration) schemes have occurred. This regulation should include a statutory standards framework to include the following:

- 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 a specified umbrella company or payment intermediary, to stop workers being pushed or encouraged to opt-out of the Conduct of Employment Agencies and Employment Business Regulation 2003
- 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 (PSC)).

- To make it a statutory obligation to quote only PAYE contract rates for temporary worker engagements that are not “outside IR35”.
- 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".<sup>4</sup>
- 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 clarify the situation regarding employer’s tax and National Insurance contributions.
- To make those who promote and operate schemes that are deemed to be forms of tax avoidance exclusively liable for any tax avoided.

**Key Recommendation 5:** We request that the REC consider publishing clearer and stronger guidance about what is ethical and acceptable when it comes to the charging of fees for being on preferred supplier lists. We would particularly like to see the REC state that no recruiter, whether a member or not, should ever insist on undisclosed kickbacks.

**Key Recommendation 6:** There should be an investigation into cases where a recruitment agency that is an approved provider to a public sector organisation, or a public sector organisation themselves, has recommended or obliged workers to use an umbrella company and/or where that worker has found themselves facing HMRC action as a result of being in a disguised remuneration/tax avoidance scheme. At the same time, public sector procurement rules must be tightened to stop any such occurrences happening in future.

## Action to shut down tax avoidance schemes and stop mis-selling

**Key Recommendation 7:** Rather than merely providing case studies of people who have ended up in disguised remuneration schemes and belatedly opening tax enquiries on scheme users, HMRC needs to be far more proactive in identifying all such schemes and clamping down on them. This will prevent such schemes operating and mis-selling to contractors, freelance and locum workers in the first place.

**Key Recommendation 8:** HMRC must properly link and reconcile the quarterly data of employment intermediaries<sup>5</sup> with the Real Time Information (RTI) submissions to promptly detect tax avoidance schemes and then take action to shut them down.

**Key Recommendation 9:** The law should be changed to make 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.

**Key Recommendation 10:** To extend the period whereby contractors can make a claim for unlawful deductions of tax, or unlawfully retained holiday pay, via an umbrella company to six years - and make directors personally liable.

## Restrict some roles to Employed Only

**Key Recommendation 11:** The Government should 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.

<sup>4</sup> Taylor Report page 47 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf#page=47](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf#page=47)

<sup>5</sup> <https://www.gov.uk/government/publications/employment-intermediaries-reporting-requirements>

## Simplify the UK tax system

**Key Recommendation 12:** We recommend that the Government recognises the hugely complex nature of the UK tax system and initiates a review on how to simplify it. This will enable HMRC to administer effectively and be much clearer for taxpayers to understand.

### Next steps – call to action

- We recommend that the appropriate Select Committee, which would probably be the BEIS Select Committee, undertake a full inquiry into the supply chain and how best to recognise, remunerate and tax professional contracting and freelancing.
- We believe that there should be a full and proper debate, during the passage of the forthcoming Finance Bill, on this issue and how best to clamp down on the clear malpractice within the supply chain, including that of some umbrella companies and some recruitment agencies, and how to make the supply chain simpler and more transparent.
- We urge the Government to announce, this year, a Government supported independent review into professional self-employment, to properly recognise and support these important and increasingly common ways of working and to decide how such working should be structured, remunerated and taxed. Due to the current situation resulting from the Covid pandemic, the Government has a responsibility to look at how people should structure self-employed, freelance and contract work so they are properly recognised and are not left vulnerable in this way ever again.
- We call on all freelance and contract workers and advisers who have experience of and evidence showing any malpractice to report it to the Employment Agency Standards Inspectorate, and to also report it to their own MP in order to present such evidence to the Government and the appropriate Parliamentary Committees, as well as reporting it to the representative bodies, if it involves any of their members.

# 1. Introduction

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1. The Loan Charge All-Party Parliamentary Group (Loan Charge APPG) was established in 2019 to bring together cross-party parliamentarians from both Houses of Parliament, who have serious and numerous concerns about the nature and impact of the 'Loan Charge'. Having inquired into and reported on problems with the Loan Charge<sup>6</sup> the APPG decided to investigate the context within which the Loan Charge was set.
2. The APPG inquiry into *How Contracting Should Work* is a Select Committee style inquiry commencing in December 2020, reporting in April 2021.
3. This inquiry plays an important part in identifying and addressing the factors that led to the situation where people now face the Loan Charge (and other related HMRC action) for use of 'disguised remuneration' schemes. The Loan Charge APPG was set up in in early 2019 and the Loan Charge Inquiry, which was published in April 2019, examined how people came to use the arrangements now subject to the Loan Charge, as well as how the Loan Charge was introduced.
4. This inquiry goes a stage further, examining in detail the reality of professional contracting and freelance working, the different ways of organising and structuring such work and the issues that have led to the use of schemes now subject to the Loan Charge.
5. The inquiry examines how contracting and freelance working should operate, be remunerated and taxed fairly and appropriately. It also looks at the factors that have led to the marketing and promotion of tax avoidance schemes and potential changes to stop the proliferation and use of such schemes and, more importantly, to prevent schemes from operating in the first place. The Loan Charge APPG believes that this is of fundamental importance in avoiding any further problems caused by the use of so-called disguised remuneration schemes, as well as properly and finally recognising contracting and freelancing in legislation. The original terms of reference of the inquiry are on the Loan Charge APPG website.<sup>7</sup>
6. Following the call for evidence, we received submissions from organisations and individuals. Some of these cannot be published as the person or organisation submitting them requested that we do not do so. Others are published, but the individual or organisation asked that we withhold their name and these submissions are published without names or identifying content. All submissions that can be published are listed in Appendix B.

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<sup>6</sup> <http://www.loanchargeappg.co.uk/wp-content/uploads/2019/05/Loan-Charge-Inquiry-Report-April-2019-FINAL.pdf>

<sup>7</sup> <http://www.loanchargeappg.co.uk/wp-content/uploads/2020/12/2020-03-12-Loan-Charge-APPG-How-Contracting-Should-Work-Inquiry-Terms-of-Reference.pdf>

7. The APPG held an oral evidence session on Tuesday 19<sup>th</sup> December 2020. The rough transcripts of the two panel sessions are listed in Appendix A.

8. The Officers of the Loan Charge APPG are currently as follows:

- Ruth Cadbury MP, Co-Chair, MP for Brentford and Isleworth (Labour)
- Rt Hon. Sir Ed Davey MP, Co-Chair, MP for Kingston and Surbiton (Liberal Democrat)
- Sir Mike Penning MP, Co-Chair, MP for Hemel Hempstead (Conservative)
- Sammy Wilson MP, Vice-Chair, MP for East Antrim (Democratic Unionist Party)
- Rt. Hon. Baroness Kramer, Vice-Chair (Liberal Democrat)
- Owen Thompson MP, Vice-Chair, MP for Midlothian (Scottish National Party)

9. The full list of APPG members is published on the Loan Charge APPG website<sup>8</sup>. The APPG thanks all those who submitted evidence and to everyone who made this inquiry and report possible.

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<sup>8</sup> <http://www.loanchargeappg.co.uk/members/>

## 2. Background

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### Scope of the inquiry and relevance to the Loan Charge Scandal

10. The inquiry looks at the nature of professional freelance and contract work and explores what model or models are appropriate and the basis on which people should be remunerated and taxed. It reflects the fact that neither group are employees and starts with the principle that people should only be taxed as an employee if they are genuinely employed, receive employee rights and benefits, and have an employment contract that abides with employment law.

11. This inquiry starts from the position (of the Loan Charge APPG) that tax avoidance schemes which seek to illegitimately avoid tax are wrong and that such schemes should be shut down. Furthermore, the promoters and operators of these schemes should be pursued and prosecuted for mis-selling and the law changed to make them liable for any tax deemed to be owed if the schemes are duly found to be proscribed or unlawful.

### The Loan Charge

12. The Loan Charge was first announced in the Budget in 2016, then introduced in the Finance (No.2) Act 2017, with supplementary provisions in the Finance Act 2018.<sup>9</sup>

13. The Loan Charge is a one-off charge which applies to the outstanding balance of 'disguised remuneration' received in loans on 5th April 2019. It was initially set to apply retrospectively to all remuneration in the form of loans since 1999. However, due to changes proposed by the Morse Review<sup>10</sup> conducted in 2019, it instead applies to loans taken since December 2010. People facing the Loan Charge had up until 30<sup>th</sup> September 2020 to agree 'voluntary settlement' with HMRC to avoid paying the Loan Charge.

14. The Loan Charge legislation does not apply to any loans made or received after 5th April 2019, so does nothing to clarify the position of any similar arrangements going forward, which are still being openly marketed and sold.<sup>11</sup> Since 2017, they have been targeted especially at public sector workers, due to the roll-out of the off-payroll working rules in 2017. With the roll-out of the rules to the private sector in April 2021, there are as a result once again many adverts targeting private sector contractors.<sup>12</sup>

<sup>9</sup> <https://commonslibrary.parliament.uk/research-briefings/cbp-8811/>

<sup>10</sup> <https://www.gov.uk/government/publications/disguised-remuneration-independent-loan-charge-review>

<sup>11</sup> <https://www.accountancydaily.co/ps600m-tax-avoidance-market-dominated-online-promoters>

<sup>12</sup> [https://www.contractorcalculator.co.uk/payroll\\_rules\\_beware\\_disguised\\_remuneration.aspx](https://www.contractorcalculator.co.uk/payroll_rules_beware_disguised_remuneration.aspx)

## HMRC's proposed strategy against tax avoidance schemes and promoters

15. This inquiry takes place at a time when the Treasury have announced new measures to seek to clamp down on promoters,<sup>13</sup> something the Loan Charge APPG have previously and continually called for.

16. HMRC are also currently running a campaign to warn people against using tax avoidance schemes called 'tax avoidance explained', in an attempt to try to educate workers who might be vulnerable to being offered 'disguised remuneration' schemes that might then be challenged by HMRC.<sup>14</sup> This is welcomed and supported by the Loan Charge APPG.

17. However, rather than just warning people against using such schemes, we believe HMRC needs to tackle the problem at source to stop these schemes from operating in the first place. This means looking at not just how to stop schemes themselves, but to also prevent the creation of an environment in which they are encouraged to operate. Merely warning people is not going to stop the promotion, mis-selling and use of schemes. From evidence we have been sent (to this Inquiry and also the 2019 Loan Charge Inquiry) some people are only offered roles on the basis of working through a specific umbrella company, so merely warning people does not tackle this (nor will it stop the ongoing mis-selling, which, however much HMRC try to warn people, will inevitably lead to some still being mis-sold schemes, not even realising they might be deemed to be tax avoidance).

**18. Recommendation: Rather than merely providing case studies of people who have ended up in disguised remuneration schemes, HMRC needs to be far more proactive in identifying all such schemes and clamping down on them, in order to prevent them operating and mis-selling to contractors, freelance and locum workers in the first place. (Key Recommendation 7)**

## Office of Tax Simplification Report 2011

19. In 2011, the Government's Office of Tax Simplification published 'The Small Business Tax Review' and recommended improved regulation of small businesses paying tax, including by simplifying the tax system.<sup>15</sup> It concluded that major structural changes were required to the UK tax system and suggested the integration of income tax and National Insurance. It also advised reducing the differential between tax rates applicable to different incomes and legal forms and a suspension of IR35 with the intention of permanent abolition. However so far, the Treasury have not implemented these recommendations.

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<sup>13</sup> <https://www.gov.uk/government/publications/tackling-promoters-of-mass-marketed-tax-avoidance-schemes>

<sup>14</sup> <https://taxavoidanceexplained.campaign.gov.uk/>

<sup>15</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/199183/05\\_ots\\_small\\_business\\_interim\\_report.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf)

## Taylor Review

20. In October 2016, the then Government commissioned Matthew Taylor, chief executive of the Royal Society of Arts, to lead an independent review looking at modern work practices.<sup>16</sup> The review focused on three key areas:

- Tackling exploitation and the potential for exploitation at work.
- Increasing clarity in the law and helping people know and exercise their rights.
- Over the longer term, aligning the incentives driving the nature of our labour market with our modern industrial strategy and broader national objectives<sup>17</sup>.

21. Whilst these points have some direct relevance to this inquiry, this report is focused primarily on contracting and freelance working.

22. The issue of ‘false’ or ‘bogus’ self-employment is not a part of this inquiry. We agree this is an important issue and believe that exploitative forms of bogus self-employment, devised solely for employers to avoid tax and also to avoid conferring workers’ rights, are morally reprehensible and should be stamped out. We note the legal ruling regarding Uber announced recently<sup>18</sup>. This inquiry is focused on how to properly identify, define and structure contracting and freelance working, as an important and genuine form of self-employment.

23. The Taylor Review report, ***Good Work: The Taylor Review of Modern Working Practices*** was published in July 2017.<sup>19</sup>

24. Whilst it was predominantly and rightly focusing on workers who were at risk of being exploited, it did include recommendations relevant to this inquiry.

25. The report proposed that ‘dependent contractor’ becomes the name for the existing ‘worker’ status, to achieve greater clarity between different forms of employment (with the others being employee and self-employed person). The intention is to try to give better definitions and clearer boundaries.

26. Dependent contractor status could, in theory, make genuine self-employment easier to prove. However, the Review also acknowledges that it is often hard to apply and distinguish between different forms of working.

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<sup>16</sup> <https://www.gov.uk/government/groups/employment-practices-in-the-modern-economy>

<sup>17</sup> [Taylor Review three challenges](#)

<sup>18</sup> <https://www.supremecourt.uk/press-summary/uksc-2019-0029.html>

<sup>19</sup> <https://www.thersa.org/globalassets/pdfs/reports/good-work-taylor-review-into-modern-working-practices.pdf>

27. The key point is that dependent contractors should receive employment rights. This is even more relevant considering the recent legal judgment regarding Uber.<sup>20</sup> The Taylor Report recommends legislation to make the situation much clearer.

28. In the Taylor Report, the three key tests of employment status are the same as those at the heart of IR35 off-payroll determinations, in other words 'control', 'personal service' and 'mutuality of obligation (MOO)'. The Taylor Report suggests that the importance of 'personal service' should be reduced, to stop unethical employers using substitution clauses in contracts. Instead, the report recommended placing more bearing on 'control'.

29. The Taylor Report also recommends aligning tax law and employment status law more closely, something that has also been raised in the debates and discussions around the IR35 off-payroll rules roll-out. This would mean that if individuals are classified as an employee under tax law, they are classed as an employee under employment law too (and vice-versa). This would deal with the situation being faced by many contractors where they are taxed as employees but have no employment rights and benefits, something referred to as 'zero rights employment'.<sup>21</sup>

30. We find it strange and indeed regrettable that the Government commissioned the Taylor Review, then ignored its conclusions and recommendations and pushed ahead with the off-payroll rules roll-out regardless, despite having clearly been told that this would lead to contractors being taxed as employees, but without any employment rights or benefits.

**31. Recommendation: We urge the Government to revisit and consider implementing the recommendations of the Taylor Review. This is a very simple but hugely significant step in resolving all the issues and problems associated with the lack of proper definition and clarity of contracting and freelancing by aligning tax and employment law, so that anyone who is taxed as an employee also receives the corresponding benefits. (Key recommendation 2)**

## Select Committee inquiries

32. There have been several Select Committee inquiries relevant to this inquiry, however none that are on the same precise area of self-employment - that is, none have looked specifically at professional contracting and freelancing.

33. The House of Lords Economic Affairs Committee (and Finance Bill Sub-Committee) have had a particular focus on this area, on IR35 (and on the Loan Charge). The key report related to this is the House of Lords Economic

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<sup>20</sup> <https://www.bbc.co.uk/news/business-56123668>

<sup>21</sup> <https://labourlist.org/2020/06/this-government-is-creating-a-class-of-zero-rights-employees/>

Affairs Finance Bill Sub-Committee's report, **off-payroll working: treating people fairly**, published in April 2020.<sup>22</sup> This looked at the proposed IR35 off-payroll roll-out to the private sector and it concluded that:

“The Government has not sufficiently analysed the unintended behavioural consequences of the proposed reforms. Contractors are already being laid off, despite the reforms' delay. Many witnesses told the Committee that the rules have made them “zero-rights employees” with none of the rights of being an employee, or the tax advantages of being self-employed”.<sup>23</sup>

34. The Committee called on the Government to keep its promise on implementing the recommendations of the Taylor Review: that the taxation of labour should be made more consistent across different forms of employment and that there should be a fair balance between tax, rights and risk.

35. We commend the work of the EAC and its Sub-Committee and are troubled at the way the Treasury and HMRC reject its recommendations.

36. In 2017, there was a joint inquiry undertaken by the Work and Pensions, and the Business, Energy and Industrial Strategy Committees, leading to a joint report and draft Bill to close the loopholes that allow companies to use bogus "self-employment" status as a route to cheap labour and tax avoidance, saying the law must not allow willingness to exploit workers to be a competitive advantage.<sup>24</sup>

37. In 2018, the Digital, Culture, Media and Sport Select Committee collected evidence and held an oral evidence session on the BBC presenters and use of personal service companies.<sup>25</sup>

**38. With no Select Committee having looked in detail at how to properly define, structure, remunerate and tax professional contracting and freelance working, we would hope that this is now something that is considered a subject for an in-depth inquiry by the appropriate Select Committee(s).**

## The Employment Agency Standards Inspectorate

39. The Employment Agency Standards Inspectorate exists to protect the rights of agency workers by ensuring that employment agencies and businesses treat their workers fairly.<sup>26</sup> The Employment Agency Standards

<sup>22</sup> <https://committees.parliament.uk/publications/786/documents/4841/default/>

<sup>23</sup> <https://www.parliament.uk/business/lords/media-centre/house-of-lords-media-notices/2020/apr-20/government-must-address-ir35-inherent-flaws-and-unfairnesses-says-lords-economic-affairs-finance-bill-sub-committee/>

<sup>24</sup> <https://committees.parliament.uk/committee/164/work-and-pensions-committee/news/97666/committees-publish-bill-to-end-exploitation-in-the-gig-economy/>

<sup>25</sup> <https://committees.parliament.uk/committee/378/digital-culture-media-and-sport-committee/news/103537/committee-publishes-written-evidence-from-bbc-on-personal-service-companies-and-announces-salford-evidence-session/>

<sup>26</sup> <https://www.gov.uk/government/organisations/employment-agency-standards-inspectorate/about>

Inspectorate (EAS) is based within the Department for Business, Energy and Industrial Strategy and employs staff across the UK, including in Scotland and Wales.

40. The EAS is tasked with working with employment agencies and businesses to help them comply with the law, investigating complaints received from agency workers and taking enforcement action, including prosecution and unlimited fines.

41. However, there has been concern and criticism about its effectiveness. Despite complaints rising by a fifth between 2011 and 2016, the number of inspections carried out by the EAS has fallen by more than half, with the agency failing to bring a single prosecution or enforce any prohibitions on unscrupulous employers between 2015-16.<sup>27</sup> The budget of the EAS was cut from £1.1m in 2009-10 to £500,000 in 2015-16 and staff numbers fell 70% in the same period.<sup>28</sup>

## Government consultation on establishing a single enforcement body

42. In 2019, the Government consulted on options for establishing a single enforcement body to improve the enforcement of employment rights for workers and businesses (including the EAS). This consultation ran from 15<sup>th</sup> July 2019 to 11:45pm on 6<sup>th</sup> October 2019.<sup>29</sup>

43. This consultation sought views on whether establishing a new single enforcement body for employment rights could: (a) improve enforcement for vulnerable workers and (b) create a level playing field for the majority of businesses who are complying with the law.

44. The Government, however, does not appear to have taken this idea forward since the consultation, yet it is apparent that this could be something which would clearly help improve oversight of recruitment agencies and payment intermediaries.

## 'IR35' and off-payroll/Intermediaries Legislation

45. At the very heart of so much of this confusion is the lack of legislative clarity over what defines contracting and freelancing and how it should be remunerated and taxed, as a distinct form of working, being clearly different from people who are directly employed and different in some ways from other forms of self-employment.

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<sup>27</sup> <https://www.theguardian.com/business/2016/aug/14/employment-agency-standards-inspectorate-worker-rights-watchdog-labour>

<sup>28</sup> <https://www.theguardian.com/business/2016/aug/14/employment-agency-standards-inspectorate-worker-rights-watchdog-labour>

<sup>29</sup> <https://www.gov.uk/government/consultations/good-work-plan-establishing-a-new-single-enforcement-body-for-employment-rights>

46. This is **all** linked to the so-called 'IR35' legislation, originally introduced by the then Chancellor Gordon Brown, which came into law on 6 April 2000. The stated objective of this legislation was to prevent workers using an intermediary company which resulted in less tax being paid than if they were employees of the client doing the same work.

47. IR35 was introduced with the intention of stamping out what has become known as bogus or false self-employment, where people who clearly were – or should have been – employed, were claiming to be self-employed simply for tax purposes. As Keith Gordon, a tax barrister from Temple Tax Chambers explains:

“It should also be noted that, at that time of the IR35 announcement in 1999, the Government expressed concern about some abusive uses of personal service companies. I remember the examples being given were doctors' receptionists and train drivers engaged by newly privatised railway companies providing their services through limited companies. Such arrangements were clearly abusive and needed to be countered”.<sup>30</sup>

48. The Loan Charge APPG agree that any such abusive arrangements were wrong and should be stopped. However, the implementation of the legislation, and specifically the way HMRC have sought to enforce it, has seen genuine contractors and freelancers at risk of being unfairly targeted. It is one of the biggest ironies of the whole Loan Charge Scandal that the arrangements contractors entered into were recommended by tax professionals with a view of protecting their clients from IR35 rules or equally to avoid a time consuming IR35 investigation.

49. Whilst it is now largely recognised that 'IR35' was devised to stop individuals who are really working as employees from paying less tax by operating as self-employed, in reality the reason many such individuals were doing so was because it suited the purposes of employers and large client companies. Employers benefited by not having to pay National Insurance and also not having to provide costly employee benefits, such as sick pay, holiday pay, maternity/paternity pay and a pension. Additionally, employers have the ability to hire and fire at will without risk of claims for unfair dismissal. The costs to employees also increased, which further incentivised employers. As Keith Gordon explains:

“Furthermore, it was probably government actions, being the steady increase in employer's National Insurance since the mid-1980s (and the increased obligations imposed upon employers – which continue today with pension obligations, apprenticeship levy as well as employment rights generally), that acted and continue to as a disincentive for businesses to take on employees when a more flexible (and cheaper) alternative exists. In other words, it is a combination of actions taken by successive governments and

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<sup>30</sup> Submission to the 'How Contracting Should Work' Inquiry by Keith Gordon, barrister, Temple Tax Chambers

“employers” that allegedly led to the IR35 announcement in 1999. However, ultimately the cost of these reforms has been borne by the workers (with no commensurate increase in rights to compensate for the additional tax and compliance burdens).<sup>31</sup>

50. One of the key reasons the IR35 legislation has created uncertainty is because it dealt only with tax legislation and not employment legislation. This created a situation where many freelance workers’ employment status was defined only by the tax they paid. As explained by Keith Gordon:

“For most tax professionals, employment status is all about tax (and National Insurance), together with the different sets of rules as to what expenses are allowable and how/when the tax is payable. Tax professionals often forget that employment status is a much wider issue than this. This can perhaps be illustrated by considering the now infamous IR35 press release issued on Budget Day 1999. That lamented the perceived loss of tax from employees by parties circumventing employment status through the use of limited companies. **It noted that such employees also lost their employment law rights, but the remedy offered concerned only the tax and not the employment rights**”.<sup>32</sup>

51. **This failure to properly align tax law and employment law is, in our view, at the heart of the whole Loan Charge Scandal, the ongoing operation of schemes and the current uncertainty created by the roll-out of the off-payroll working rules.**

52. This is described clearly by the Loan Charge Action Group (LCAG) in their submission:

“IR35 legislation was introduced in 1999 and took effect in 2000, essentially meaning HMRC could tax contractors and freelancers as employees without them benefiting from any of the usual employment benefits or protections.”<sup>33</sup>

### *How does the legislation work?*

53. IR35 considers limited companies, personal service companies, partnerships and individuals as possible intermediary companies and applies common law tests that include whom controls the work being carried out, whether the contractor has to perform the work themselves or can alternatively provide a substitute, and whether the client is obliged to provide ongoing work for the contractor which the contractor is duty-bound to accept. Typically, if all three of these conditions are met then the contractor is classified as being “inside IR35” and then taxed on their income as though they were a full-time employee under PAYE.

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<sup>31</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Keith Gordon, barrister, Temple Tax Chambers

<sup>32</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Keith Gordon, barrister, Temple Tax Chambers

<sup>33</sup> Submission to the ‘How Contracting Should Work’ Inquiry by the Loan Charge Action Group (LCAG)

54. Other factors that are considered when determining IR35 status include:

- Whether the contractor or freelancer is subject to a significant degree of financial risk.
- Whether the worker has, at their own expense, had to provide items required for the assignment.
- Whether the fee is a one-off sum or consists of regular payments throughout the assignment that are paid irrespective of whether the assignment completes to schedule.
- Whether the worker is in business on their own account or are really part and parcel of their client's own business.

55. HMRC has provided a tool called the Check Employment Status for Tax (CEST) which has been designed to assist employers in determining the IR35 status of their contract workers. The APPG has received several submissions that describe this tool as not fit for purpose.

56. Freelance accountant Kevin Briggs calls it a "fiasco":

"HMRC's Check for Employment Status Tool is a fiasco. First, HMRC tell people to use it but at tribunal hearings they won't rely on it. Second, by excluding mutuality of obligation (MOO) it doesn't include all assessment tests necessary (back to tax vs employment law). My submission argues that lack of MOO is critical to client-freelancer contractual arrangements (insurance, responsibility for correcting errors, time and place for doing work, marketing effort, training, no work risk etc). For evidence on both points, please refer to RALC Consulting Ltd vs HMRC: here a reputable professional journal describes HMRC's approach as "madness". This emboldens tax avoiders".<sup>34</sup>

## *Problems*

57. The legislation does not consider the expenses that a contractor incurs. A permanent employee receives employee benefits that a contractor historically had to finance themselves. A contractor needs to consider how to fund holiday, maternity/paternity & sick pay, training and professional qualifications, insurance (Business, Professional Indemnity, Private Medical, Critical Illness Cover), accountancy & administration, travel & subsistence, PPE & pension.

58. Most parties in the contractor supply chain lack sufficient expert knowledge as to how to interpret the underlying common law in order to ascertain the correct status and are concerned that the only interpretation that matters seems to be that done by HMRC. Many APPG submissions indicated a huge mistrust of HMRC and

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<sup>34</sup> Submission to the 'How Contracting Should Work' Inquiry by Kevin Briggs, Freelance Accountant

said that their guidance was biased and designed to encourage firms to categorise their workers as “inside IR35”, irrespective of the law. Under the original legislation, any appeal against a decision by HMRC is hugely expensive to mount - under the more recent legislation, there is no route to appeal at all.

### *2017 Roll-out of the ‘off-payroll Working Rules’ to the Public Sector*

59. In 2017, reforms were made to the IR35 implementation in the Public Sector, introduced by the then Chancellor Phillip Hammond. These made the end client, the hiring organisation (in this case public authorities), responsible for determining the IR35 status of their workers. Where it is determined that a worker falls within IR35 they must recalculate the contract worker’s payment and report the information to HMRC. This recalculation includes establishing deductions for tax, NI and VAT whilst considering the worker’s cost of materials and allowable expenses.

60. The impact of these reforms, as covered in the Loan Charge APPG’s Loan Charge Inquiry<sup>35</sup> published in 2019, has been another large subset of individuals being mis-sold ‘disguised remuneration’ schemes and ending up facing large retrospective tax demands from HMRC. This group has included frontline NHS locum workers, nurses and doctors, as well as social workers and teachers.

61. So, whilst originally these schemes that are now subject to the Loan Charge were mainly targeted at professional contractors in what might be termed ‘white-collar’ sectors (such as IT consultants, oil and gas workers), those marketing the schemes, especially since 2017, have increasingly targeted public sector workers, including many middle and low paid professionals in the NHS and local authority social workers. There were numerous reports in Spring 2020 about NHS workers returning to help with the COVID-19 pandemic being targeted by promoters and operators of tax avoidance schemes.<sup>36</sup>

62. Many of these people had no idea they have even been placed into a ‘disguised remuneration’ or tax avoidance scheme and in cases covered within the Loan Charge Inquiry (and included again in section 7(b) of this report) were pushed into using umbrella schemes or actually directed to a single provider, who then put them into a scheme that has now led to them facing action from HMRC.

63. HMRC’s report, ‘Use of Marketed Tax Avoidance schemes in the UK’, originally published on 20<sup>th</sup> November 2020 and updated on 17<sup>th</sup> March 2021, also reports that healthcare workers are being targeted by scheme promoters.<sup>37</sup> Some NHS Trusts have reported on the HMRC report, to warn locum staff. <sup>38</sup>

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<sup>35</sup> [Loan Charge Inquiry Report April 2019 Page 10](#)

<sup>36</sup> <https://www.ftadviser.com/companies/2020/03/31/returning-nhs-workers-targeted-by-tax-avoidance-schemes/>

<sup>37</sup> <https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk>

<sup>38</sup> <https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk>

## *2021 Roll-out of the ‘off-payroll Working Rules’ to the Private Sector*

64. From April 2021, these same reforms are being rolled out to the private sector. This was deferred for a year due to the Covid pandemic and the concern expressed by MPs, including a significant number of Conservative party backbenchers. Many had been contacted by constituent contractors who were worried about the impact of the change and how their work would be adversely affected or threatened.

65. Already, a significant amount of UK contract work is being moved offshore and as a consequence no tax or NI will be paid on this at all. In IR35 Shield’s December 2020 survey, 36% of the contractors surveyed reported that their client was moving some or all of their projects outside of the UK due to IR35.<sup>39</sup> It is logical to assume that this figure is likely to be consistent throughout the contractor supply chain. One of many such example of companies ‘offshoring’ work to other countries was Argos relocating their digital team from Milton Keynes to Mumbai.

66. According to Dave Anderson, Director of Brooke Anderson Consulting Engineers Ltd, the proposed changes are causing more confusion, not less:

“The planned changes to IR35 will shift the responsibility for determining IR35 status from self-employed businesses like mine to end-clients. As it is, judging IR35 status is notoriously complex and uncertain. It is evident that clients are avoiding making these judgements and instead minimising risk by enforcing blanket IR35 decisions, forcing contractors – whether they should be under IR35 or not – to pay employee taxes and the employers’ National Insurance charge (an effective rate of around 50 per cent).<sup>40</sup>

67. Freelance accountant Kevin Briggs explains how IR35/off-payroll rules do not make sense in the real world:

“Freelancers are paid day rates because commitment to change programs is open ended. The client may not know how long an assignment will take or even what’s required (freelancers advise this once inside the business). Sometimes, a fixed fee for the contract is agreed where outcome is more certain. Completion or success bonuses used to be paid; whilst clients see the advantage of bonuses to ensure work is completed to time and standard, they’re discouraged because off-payroll rules see these payments as control by the client rather than what it is – payment for successful outcome. This is an unnecessary tax distortion in the market”.<sup>41</sup>

<sup>39</sup> [https://www.ir35shield.co.uk/Files/IR35Shield\\_Contractor\\_Survey\\_2021.pdf](https://www.ir35shield.co.uk/Files/IR35Shield_Contractor_Survey_2021.pdf)

<sup>40</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Anderson, Anderson Consulting Engineers Ltd

<sup>41</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Kevin Briggs, Freelance Accountant

68. One contractor's submission has raised the fact that making clients liable has actually led to them not taking the risk:

"Clients will not engage domestic [UK based] freelancers after April 2021 because they do not want the new liability associated with the coming IR35 reform. Most large companies have made blanket contractor "no engagement" decisions based on advice from corporate lawyers".<sup>42</sup>

69. As one submission pointed out, not only has the roll-out of the off-payroll rules prompted client organisations to engage offshore providers, meaning an immediate loss to the UK economy, but has also led, in effect, to *significant tax avoidance*, by avoiding any potential risks with UK employment taxes by **only** hiring offshore workers:

"The approaching IR35 reforms in the private sector have seen many big corporate clients swap domestic contractors for offshore outsourcers. This is tax avoidance on a huge scale - not just shaving a couple of percent off National Insurance. Outsourcers are only paying UK taxes on the few, poorly paid representatives that work in the UK. Most of the money goes to offshore workers and shareholders who (quite legally) avoid UK tax".<sup>43</sup>

70. There is also the danger that the off-payroll roll-out into the private sector will lead to another situation where many workers are lured into disguised remuneration schemes, as happened with public sector workers following the 2017 roll-out. So, there is the very real danger of another 'Loan Charge' type situation, in which large numbers of people unwittingly use schemes and are later faced with huge demands from HMRC. This is expressed by Dave Chaplin:

"The worry, as we approach April 2021, is that many agencies are forcing contractors to use unregulated third-party payroll companies, and we are likely to see a significant number of contractors unwittingly drawn (once again) into schemes, the consequence being the same problems created by the Loan Charge".<sup>44</sup>

71. Later in this report, we will investigate the direct links between IR35 legislation and the proliferation of disguised remuneration/tax avoidance schemes.

72. The House of Lords Economic Affairs Committee Sub-Committee summarised the reality of the situation very clearly in their report **off-payroll working: treating people fairly**. To quote Lord Forsyth of Drumlean, Chair of

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<sup>42</sup> Submission to the 'How Contracting Should Work' Inquiry, Name withheld 5

<sup>43</sup> Submission to the 'How Contracting Should Work' Inquiry, Name withheld 5

<sup>44</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Chaplin, ContractorCalculator and IR35 Shield

the House of Lords Economic Affairs Finance Bill Sub-Committee, from comments issued at the time the report was published:

“...our inquiry found these rules to be riddled with problems, unfairnesses and unintended consequences. The potential impact of the rules on the wider labour market, particularly the gig economy, has been overlooked by the Government. It must devote time to analysing all of this. A wholesale reform of IR35 is required...contractors already concerned by these uncertain times now have the added worries of paying more employment taxes and having their fees cut by clients making additional National Insurance contributions. Also concerning is the number of companies getting rid of contractors in anticipation of the implementation of these new rules.”<sup>45</sup>

73. The Treasury effectively dismissed the Committee report out of hand. This is despite the Committee’s conclusions being based on evidence of the problems that IR35 had caused in the public sector and the concerns that were being raised in the private sector ahead of the private sector roll-out. The way that Government currently ignores such reports and rejects most (if not all) recommendations is troubling and this is proving a demonstrable weakness in our system as any Parliamentary oversight of Government is simply being sidestepped. We believe this is something that should be looked at as part of a proper review and investigation in to the lack of accountability of HMRC, something we have recommended previously and still strongly assert as a necessary imperative.

## Coronavirus/Covid-19

74. A stark reminder of the lack of definition or recognition of much self-employment and many contractors and freelancers has been the way that so many have been left with little or no support during the Covid-19 crisis.

75. Groups Excluded UK<sup>46</sup>, Forgotten Ltd<sup>47</sup> and Forgotten PAYE<sup>48</sup> have all powerfully highlighted how freelance and contract workers (and with Forgotten Ltd especially, such workers working through limited companies) have been excluded from Government support during the crisis, despite having lost work due to Government-imposed restrictions.

76. This was specifically mentioned by some who provided evidence, including IT freelancer, Andy Stokes:

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<sup>45</sup> <https://www.parliament.uk/business/lords/media-centre/house-of-lords-media-notice/2020/apr-20/government-must-address-ir35-inherent-flaws-and-unfairnesses-says-lords-economic-affairs-finance-bill-sub-committee/>

<sup>46</sup> <https://www.excludeduk.org/excluded-uk-an-inclusive-alliance-for-the-excluded>

<sup>47</sup> <https://forgottenltd.com/>

<sup>48</sup> <https://www.forgottenpaye.co.uk/>

“I feel that many workers that fall into the categories of contractor or freelancer have been left largely unsupported by HMG, HMT and HMRC during the 2020 coronavirus outbreak...This reflects what I generally believe to be either a lack of concern and/or understanding on the part of HMG/HMT/HMRC of the nature of such workers and their vital contributions to the United Kingdom, and I am pleased that the work that bodies such as the APPG, individual MPs and the House of Lords Economic Affairs Committee are doing in order to address such institutionalised flaws within Government”.<sup>49</sup>

77. We believe that this crisis has shown how serious and how unfair it is that so many workers are not properly recognised, do not have a model of working that appears to be acceptable to the Treasury and HMRC and have suffered seriously as a consequence.

**78. Due to the situation caused by the Covid pandemic, the Government has a responsibility to look at how people should structure self-employed, freelance and contract work so they are properly recognised and are not left vulnerable in this way ever again.**

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<sup>49</sup> Submission to the 'How Contracting Should Work' Inquiry by Andy Stokes, Andy Stokes Consulting Ltd

### 3. What defines and distinguishes contracting and freelancing?

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#### What defines contracting and freelancing and what is the difference between the two?

79. Contracting and freelancing are terms that are often used interchangeably and are both regularly used to describe professional self-employed workers.

80. A common differentiation is that freelancers tend to work for several clients simultaneously on a per-hour or per-day basis and often from their own home.

81. Conversely, contractors tend to work for a single client at a time and are often full-time on assignments that last several months. Contractors are normally required by their client to work on site although working from home is also frequently allowed.

82. Andy Stokes makes this clear distinction between contracting and freelancing and also makes clear that it is contractors, working for a single client at any one time, that are more likely to be caught up in tax avoidance schemes:

“Whilst the two terms (contracting and freelancing) may be seen as interchangeable I believe there is a fundamental difference: contractors are generally engaged with an exclusive end-client for a specified timescale, operating serially between client engagements. This group is much more likely to be caught up in tax avoidance schemes. Freelancers are generally engaged on a non-exclusive basis, often engaging with multiple clients in a parallel fashion. This group is much less likely to be caught up in tax avoidance schemes”.<sup>50</sup>

83. Both contractors and freelancers are (or should be) temporary staff used to cover a resource demand that cannot be met using permanent employees. This demand could be caused by a temporary increase in the client’s work, a temporary demand for a set of skills that the client’s own employees do not have, a specific exercise that needs completing or to provide an external objective view. Organisations are often reluctant to take on permanent members of staff for these types of situations as recruitment is expensive and permanent employees have ongoing costs that need to be paid. Contract staff are relatively easy for the client to onboard and offboard.

84. Contract staff do not have to be paid when they are not working (no holiday, maternity/paternity or sick pay) nor are they granted any of the many employee benefits or rights. If a contractor’s assignment takes

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<sup>50</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Andy Stokes, Andy Stokes Consulting Ltd

longer than was originally anticipated, the scope is extended or develops into a completely different piece of work altogether; thus, due to the inherent flexibility within this type of engagement, the contract with the temporary worker is also easy and convenient for the end-client to extend.

## Why do client organisations use contractors?

85. Some industry sectors are almost wholly based on a contractor model, with the oil and gas industry being good examples of these.

86. Dave Chaplin (ContractorCalculator/IR35 Shield) has defined contractors as follows and describes the reason client companies want to use them:

“Contractors are individuals who have opted out of the whole idea of a long-term career in employment, working their way up the ladder. They generally don’t want to go into management and prefer to stay on the coalface and be the best at what they do, train themselves to stay super sharp, and charge a hefty premium for being subject matter experts. They are in charge of their own professional destiny.”<sup>51</sup>

87. This is echoed by accountant Kevin Briggs as to why freelancing works for both client and contractor:

“Companies will always demand freelancer services as they don’t have (and short term, don’t need) the capability and flexibility that freelancers offer, irrespective of company size, location (some assignments are international), scenario or industry. Government says that it encourages freelancers for the beneficial effects of a flexible and entrepreneurial workforce but levelling the tax between employed and self-employed with no compensation for social security benefits takes the shine from that authenticity”.<sup>52</sup>

88. Dave Chaplin explains why firms use workers in this way, as well as bemoaning the lack of understanding in the Treasury and HMRC about this way of working and why it is important to client organisations:

“Firms hire contractors because they want a frictionless, risk-free way of accessing on-demand skills. This is why the limited company model has worked well for years. Due to the interposition of the company, firms have no long-term tax risk, no employment rights risk, and balance sheets remain clean. It suits both parties”.

“To remain competitive, firms need fast, frictionless and risk-free, on-demand access to expertise to complete one-off projects or satisfy seasonable demand spikes. Professional contractors work hard, often self-training, to keep their skills current in order to then compete for high valued contracts. Some contractors work near-on full-time, whilst others take long breaks between contracts. Either way, they are buying into a

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<sup>51</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Chaplin, ContractorCalculator and IR35Shield

<sup>52</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Kevin Briggs, Freelance Accountant

lifestyle where they are in charge of their own professional destiny and can choose when and where they work and what they work on.”<sup>53</sup>

## Why do people become contractors?

89. Contractors tend to be individuals who have chosen not to follow the normal career ladder and prefer to continue performing a particular job or role that they enjoy. Sometimes people may contract because of personal lifestyle benefits (maybe family commitments or a desire to try different sectors of work) or because their age and experience presents them with challenges in meeting the conventions and expectations associated with permanent employment.

90. Maria Hauret has explained that for many contractors, it is not a deliberate decision to be a contractor – instead, it is the actual reality of what opportunities are being offered, but also the need for some workers to move away from being employed for other reasons:

“I never set out to be a contractor. It was a situation I fell into. Effectively I started my career working for a management consultancy and I was there for about nine years before I effectively reached the glass ceiling, as it were. Finding myself being put into roles that I wasn't enjoying and during that time I'd been fortunate enough to put in place a large network of clients and starting to build up a bit of a reputation for myself.”

“So, when I was invited by one of the clients to work for them on a fixed-term contract, I jumped at the chance. And this is going back to around 2003, so quite some time ago, unfortunately. And that effectively started my career. I had my network, I found my roles, I went to clients' sites, basically just performing roles according to my skillset. So, in terms of what I did, I focused on the work that I really enjoyed, which was very specific and entirely up my street and played very much into my skillset. And because I was fortunate in that, I managed to succeed at the work which I did and it was quite niche and very few people had experience in it. I was sought after.”

“So that perpetuated the fact that I was effectively working on fixed-term contracts, joining companies with the knowledge that I was going to be leaving. I was there to fulfil a requirement. Effectively, I sold myself as a commodity, delivering a service as I saw it. And I was happy, because it felt like I was making a difference to where I was going. During that stage, as I said, I didn't work too much with recruiters. I was just fulfilling the obligations that I needed to in order to perform the role I was doing as a contractor. So generally, the contracts would last a year, if not longer, and then be renewed. As I said, focusing on specific areas, but

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<sup>53</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Chaplin, ContractorCalculator and IR35Shield

ultimately, the intention was always there to do the job and then leave as a disposable [*member of the*] workforce.”<sup>54</sup>

91. Contractor Caroline Clark, a member of the Loan Charge Action Group, explains how and why she became a contractor/freelancer:

“So, I looked very much into contracting. There were a lot of advantages for me. One is I selected the work I wanted to do rather than being put on it. I was selecting the type of training I wanted to do, I decided what pension I wanted to get paid. I decided what holidays I took. So, there was a big advantage for me to do it.”<sup>55</sup>

### Lack of rights and risk

92. Where contractors and freelancers are deemed employees for tax purposes, they do not receive employment rights and benefits that an employee otherwise would. These benefits include holiday pay, maternity/paternity and sick pay. Professional costs (professional insurance, critical illness cover, pension and accountancy) have to be paid out of the contractor’s net income. Costs incurred as a direct result of fulfilling the contractual obligations, for example travel, accommodation and subsistence are not reimbursable. Maria Hauret outlined her situation:

“When I started, I was put on a fixed-term contract. So, I was on PAYE by the client, but I didn't have any benefits - holiday and sickness and so on. Although, I know very few contractors who actually do take holidays and sickness, possibly for that reason. After the first year, actually, I went on maternity leave and I had Statutory Maternity Pay and so on, but nothing as a benefit from the clients. And in my view, that differentiated me from being an employee.”<sup>56</sup>

93. There is also a far higher risk associated with contracting when compared with regular employment. There is no guaranteed or minimum length of contract - contractors can be hired and removed as the client requires. Free market rates are not guaranteed and are based entirely on supply and demand. Clients can even reduce rates mid-contract. Additionally, there are also credit risks for the contractor. If the client’s business fails, the contractor’s limited company may not be paid for completed work at all. If business has been sourced through a recruitment agency (as it frequently is) there is also the potential risk to consider of the agency business failing too. An agency will not pay the contractor unless they have first received payment from the client. Like clients, agencies prefer to issue contracts to a limited company as the liability to the agency is thereby reduced.

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<sup>54</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>55</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>56</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

94. This lack of benefits, the lack of guaranteed income and the inherent risks of self-employment are the reasons given why contractors are paid more (and in the view of some, should be taxed less, though that is a position that remains open to debate). Dave Chaplin has said:

“Professional contractors get paid more than their permanent counterparts because that’s how the free market works. No-one leaves the security of full-time employment to get paid less. Anyone who has hired a plumber for a day knows that they don’t earn 365 times that in a year if they took a permanent job. We call that extra amount the freelancer is paid the “freelancer premium”, which in IT can often mean paying twice as much for someone compared to hiring an equivalently skilled permanent employee.”

“Unfortunately, this disparity is not recognised by the Treasury or HMRC – and to date no studies have been conducted by them to measure this. Whilst the percentage of tax siphoned off the transaction when a contractor is hired is less than when an employee is hired, the contractor is earning more money, so this generates a larger amount in tax. HMRC are getting a smaller slice of a much bigger pie, but they want even more pie.”<sup>57</sup>

### Lack of a single approved way of operating

95. The lack of a single, standard and (HMRC) approved way of operating for professional contractors and freelancers is a significant problem, and one that is outlined and emphasised in many submissions alongside other evidence sent to the Loan Charge APPG.

**96. The lack of an accepted, approved way of operating and the direct threat of being classed as a ‘deemed employee’ is a fundamental problem. This has been a key reason why contractors and freelancers have used arrangements that have, in many cases, led to them being (mis)sold schemes later deemed to be tax avoidance schemes (and in many instances now subject to the Loan Charge).**

97. The lack of any dependable clarity and the prevailing confusion is not only a significant problem for contractors - it is also a problem, ironically, for HMRC themselves, who have now lost numerous legal cases regarding freelance working. This powerfully illustrates the problems with not having a proper definition for this kind of working and an agreed, standard way for such workers to operate. As Kevin Briggs put in his submission:

“HMRC losing employment status cases at tribunal shows it lacks legal understanding. Cases are taken to tribunal unnecessarily, leading to taxpayers’ worry and loss of earnings and wasting public money on cases that HMRC can’t win.”<sup>58</sup>

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<sup>57</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Chaplin, ContractorCalculator and IR35Shield

<sup>58</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Kevin Briggs, Freelance Accountant

98. In some cases, the lack of any clear ‘HMRC-preferred’ model of operating for contractors is even more evident and in many instances contract workers had literally no other option than to set up their affairs in the way that they did.

99. Niall Finucane, a passenger airline pilot, describes the situation he was in, with the airline not giving him the option of being an employee and how he then sought and received advice directly from HMRC (who did not tell him not to use the scheme, which later became subject to the Loan Charge):

“When I began zero-hour contracting, I was told by two separate tax professionals that the current models for self-employment do not fit and that I should seek HMRC help, which I did. They told me the loan scheme I was about to enter was legal, they agreed I DID NOT have a legal alternative.”<sup>59</sup>

100. He goes on to give the example of the situation for ‘self-employed’ passenger airline pilots and the unique situation they are in:

“A pilot on a zero-hour contract is faced with the same dilemma today;

- you do not supply the equipment
- you cannot nominate a substitute
- you cannot charge a rate
- you cannot nominate your own days off
- you cannot work for whoever you want
- you cannot take out your own indemnity insurance
- you cannot truthfully register as self-employed or work as your own company in the UK.”

101. Whilst we believe that this example probably falls under the category of bogus self-employment, as looked at in the Taylor Review, it does nonetheless demonstrate the consequences of not having proper definitions for self-employment or a clear and recommended standard method of operating, which would have prevented this situation.

102. Niall confirms that in other countries, there are some professions where an individual cannot legally be self-employed:

“The Netherlands, for example, has a list of professions where the individual CANNOT be self-employed, a pilot is one of them. HMRC should have such a list.”<sup>60</sup>

103. We believe the current lack of definition and recommended ways of operating show that the issues around bogus self-employment are something that some professional workers also experience themselves, and that this is therefore yet another reason why the Government **must** implement the recommendations of the Taylor Review.

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<sup>59</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Niall Finucane, Airline pilot

<sup>60</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Niall Finucane, Airline pilot

104. We also are aware from other submissions made to the Loan Charge APPG by passenger airline pilots that there are numerous pilots caught up in the Loan Charge Scandal and facing huge demands from HMRC. This is deeply worrying, considering the known mental health impact on individuals facing these sorts of life-changing demands which are, in many cases, simply unaffordable and will lead to bankruptcy and loss of further jobs and income. To have passenger airline pilots under this level of anxiety and stress is a serious concern and must surely raise safety issues. This is in addition to the Covid pandemic which has meant that employment prospects for freelance airline pilots are now particularly and especially bleak. The aviation sector has indicated that it will take at least a further three years to recover.

**105. Recommendation: We believe that this situation should be reviewed by Government (presumably by the Department for Work and Pensions) as to whether there are specific professions who cannot be self-employed or can *only* be employed, with commercial airline pilots being on any such list. (Key Recommendation 11)**

## 4. How is contracting remunerated and taxed

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106. There are several ways in which contractors can be engaged, remunerated and structured. The most common of these include:

- a) Use of limited companies (known as 'personal service companies') and/or
- b) Use of a payment intermediary or umbrella company, to legally employ the contractor.

107. Clients who do not wish to hire a permanent employee tend to mandate that contractors operate through a limited company. Whether the limited company is the contractor's own, or alternatively an umbrella company or a recruitment agency, it makes no difference to the client. They do not want any perceived risk to exist of an employment relationship with the contractor and a possible HMRC employment status challenge. This would generate additional obligations and costs for the client such as National Insurance contributions and the Apprenticeship Levy in addition to the client also having to provide employment rights.

### Limited Companies

108. Previously, the model of contractors operating through limited companies was considered the norm and in many cases client companies and businesses would only engage contractors operating through limited companies. For many decades, contractors have set up their own limited companies through which they have provided services for clients.

109. A contract is agreed between the contractor's limited company and the client (or recruitment agency offering the work) and as work is completed, invoices are raised by the limited company in accordance with that agreement. After allowable expenses and a small salary are accounted for, corporation tax is paid on the remaining profits, leaving distributable profits which can be paid as dividends. Whilst both employee's and employer's National Insurance is paid on the salary, it is not payable on dividends. However, it is primarily the absence of the need for the client to pay Secondary Class 1 NICs (employers' NI) on the monies paid to the contractor's limited company which the Treasury is concerned with.

110. Contractors operating through limited companies receive no benefits from the client or agency. They only receive the benefits that they provide themselves through their own limited company. The contractor must factor these and other expenses into the overall costs of operating. Therefore, given that they are perennially in precarious work with no job security, their higher earnings are reflective of the need to put monies aside for periods when they are not working, time which is required to seek the next opportunity and the funding of benefits and costs that would normally be paid by an employer.

111. The limited liability status of a company also provides tax protection for clients because they do not (until after April 2021) suffer from any long-term potential tax risk as they would do if they hired a sole trader.<sup>61</sup>

112. Contractors with limited companies are also protected in instances where they may be sued by their suppliers if any circumstance arises which might be considered a breach of, or default on, that contract.

113. Due to the proposed roll-out of off-payroll rules to the private sector in April 2021 and the adverse impact on many contractors of the IR35 legislation, use of limited companies by contractors has reduced whilst the use of umbrella companies has increased.<sup>62</sup> This is especially the case as we approach April 2021 and the impending roll-out of the off-payroll rules, as some firms are now refusing to hire limited company contractors, for fear they will be liable if the contractors are later deemed to be ‘inside IR35’.<sup>63</sup>

114. Although some contractors continue to operate through a limited company, many still regard this as a risk because of the IR35 legislation. IR35 contains several common law tests to determine whether an individual is a “deemed employee” and thus should pay additional tax. HMRC regard “disguised employees” as those who work via their own limited companies while still performing the same work under the same conditions as traditional permanent employees. If a contractor works through their own limited company and is judged by HMRC to be a “deemed employee” of the client, all the contractor’s income will be taxed as employment income. To mitigate this risk, some contractors choose instead to work through an umbrella company, which means they pay taxes as if “inside IR35” anyway.

## Umbrella companies/payment intermediaries

115. Rather than using a limited company, many contractors now use an umbrella company, to work on temporary contract assignments but through one payment intermediary, that then also technically ‘employs’ them. It provides the administrative services that contractors would normally have to provide themselves such as raising invoices, operating a PAYE system and charging VAT. An umbrella company is a company through which a contractor works, in order to avoid the potential risks of operating through a limited company and being later identified as a ‘deemed employee’.

116. The umbrella ‘employer’ invoices the recruitment agency or client for the work undertaken. The umbrella company pays the required employer’s National Insurance, the Apprenticeship Levy (if applicable), pension contributions and holiday pay and also charges a fee. The umbrella company runs a payroll and deducts

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<sup>61</sup> Sole Traders run their own business as an individual, are self-employed and pay tax through self assessment

<sup>62</sup> [Loan Charge Inquiry Report](#)

<sup>63</sup> [IR35Shield Road Ahead Survey](#)

employee's National Insurance and income tax. The fee that the agency charges to the client should include employer's tax liabilities, so that the contractor rate is only liable for **employee's** tax liabilities.

## 5. The Supply Chain

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117. This section describes the role of each of the elements in the supply chain.

### Clients

118. Client organisations are the end hirer of contract and freelance labour. The source of all income into the supply chain is from the hiring organisations, whether that is paid to the contractor through a limited company, via an umbrella company or to a recruitment agency.

### Recruitment Agencies

119. Recruitment agencies provide a service to both clients and contractors, by seeking to match people to work opportunities and thus fulfil the client organisation's need for extra work resource and also provide the contractor with work. They establish a list of work opportunities in the marketplace and a list of candidates who are available to perform that role. They then provide the client with CVs of the appropriate candidates and if required set up interviews so that the two can meet. If the candidate is successful, rates are agreed and contracts drawn up by the agency so that a contractor can commence an engagement with the client.

120. Clients use recruitment agencies as they can often source workers at a lower cost and with less effort than they can do so themselves, and also means they are hiring at arm's length, reducing employment rights risks. Agencies tend to specialise in a particular market so that they become better acquainted with the available workforce and the skill sets that are in demand.

121. Contractors use recruitment agencies as they do not always have the time, marketing skills or personal network to seek out and establish their next work assignment. Contractors do not get paid if they take time off to find new assignments, whereas recruitment agency staff are proactively sourcing assignments every day. Although contractors often have specialist skills, selling their own services may not be one of them. Agencies must be good at selling the services of others as this is how they earn their income. Agencies also have large client contact databases through which they can make enquiries. Individual contractors tend to deal with a limited scope of contacts compared with an agency and are generally less aware of opportunities that arise. In many cases and in many areas of work, especially in the public sector, contract and locum roles are only advertised via recruitment agencies and therefore this is the only means for people to obtain contract work.

122. When an assignment is agreed, the agency will draw up two contracts:

- A contract between the agency and the client, and

- A contract between the agency and the contractor's representative organisation (which could be their own limited company or an umbrella company).

123. The rates on these contracts are negotiated by the agent with both client and contractor separately. The difference in these rates represents the agent's margin. Although some clients will specify what is an appropriate margin for the agency, the agency will charge (to the client) and pay (to the contractor) whatever rates they are able to negotiate.

124. The margins charged by agencies have historically been a cause of some contractor resentment. On a more positive note, some contractors have suggested that they receive a better rate working through an agency as these are more adept and experienced at negotiating rates with clients than the individual contractors are themselves.

125. Assignment work completed for the client is invoiced by the contractor (or their umbrella company) to the agency at agreed rates and intervals. Similarly, the agency will invoice the client for the contractor's work at agreed rates and intervals. Once the agency's invoices have been paid, they will then pay the invoice submitted by the contractor (or umbrella company). When using an agency, the contractor has the risk of the client and/or the agency not paying, although some agencies will use factoring services to mitigate this risk for themselves and their contractors.

126. Although some contractors may be able to obtain assignments without using the services of a recruitment agency, some end-clients insist that contractors (or their umbrella company) must invoice through one. This may be because they want to ensure that there is additional demarcation between themselves and contract staff or because they have an agreement with the agency that all external contractors working for them will operate in this same way.

## Umbrella companies/payment intermediaries

127. As discussed in the previous section, working through an umbrella company has become a common way for contractors to operate and examining this element is a key part of this inquiry.

## Representative Bodies

128. There are three key representative bodies covering the relevant parts of the supply chain - that is, umbrella companies and recruitment agencies.

129. The FCSA (Freelancer & Contractor Services Association) is an association that was established twelve years ago by some of the largest umbrella companies to address the lack of compliance in the payment intermediary

sector. It has 65 members who collectively employ 170,000 contractors. Their members consist of umbrella companies, limited company accountants and CIS (Construction Industry Scheme) payment intermediaries.

130. Professional Passport is a representative organisation for umbrella companies that also performs compliance assessments on payment intermediaries. There are currently 74 member companies.

131. The REC (Recruitment & Employment Confederation) is an industry body for recruitment, providing support to recruiters, employers and jobseekers, and has a current membership of 3,300 businesses.

## Compliance and Voluntary Regulation

132. There is no statutory regulation of umbrella companies or payment intermediaries.

133. Both the FCSA and Professional Passport operate accreditation schemes.

134. Crawford Temple of Professional Passport laid out the role of compliance standards:

“Many organisations now require a compliance standard where a payment intermediary is in the supply chain with Professional Passport and FCSA emerging as the leaders in this area.”

“This increasing requirement by recruitment companies, clients and MSPs has resulted in it becoming harder for the non-compliant providers to access large parts of the market. In many consultation responses previously made, it has been highlighted that the way to limit the volume of these schemes would be to prevent their access to the market. This would make the rewards available significantly lower and therefore discourage many from developing the offerings.”<sup>64</sup>

135. There is clearly a problem with non-compliant umbrella companies/payment intermediaries that are not members of either organisation, and which is duly acknowledged by both organisations themselves.

136. The FCSA concedes that within the Industry there are certain practices that they are powerless to prevent, as well as reporting a proliferation of umbrella companies, due to the IR35 reforms:

“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.”

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<sup>64</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Crawford Temple, Professional Passport and PRISM

“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.”<sup>65</sup>

137. Professional Passport estimate that there are over five hundred companies that would describe themselves as umbrella companies, but are keen to point out that some, in their view, are not genuine umbrella companies:

“I would guess that somewhere around 500+ companies would describe themselves as umbrella companies. However, we would not recognise all those that describe themselves as an umbrella to meet the credentials of a compliant umbrella model. Some are schemes masked as umbrella companies.”<sup>66</sup>

138. In terms of recruitment agencies, Neil Carberry explains the reality of how many there are and how many are members of the REC:

“The REC has 3,300 members, typically larger agencies. We have about 80% of the market by volume in membership. We have 3,300 agency members. There are 30,000 agencies in the country. The scope of activity is very broad, and I can't pretend that the REC speaks for everyone in the industry.”<sup>67</sup>

139. This means that, as fully acknowledged by all three bodies, the majority of companies in the supply chain are not members of these organisations and therefore don't have any compliance standards or sector oversight.

140. Phil Pluck from the FCSA gives a sense of the issues, with most umbrella companies not being members of any organisation:

“We are an organisation that is based purely on compliance, so that we can tell the supply chain and the contractor that we represent compliant, legal, ethical companies. But at the same time, we only have 63 members. We've grown from five to 63, and we reckon that there are probably in the region of 800 to 900 umbrella employers in the UK.”<sup>68</sup>

141. Crawford Temple describes how he becomes aware that a non-compliant umbrella company has entered the market and is offering what is likely to be a tax avoidance scheme:

“We see many instances where we can identify a scheme has entered an organisation as the compliant providers will lose all their clients within a matter of days.”<sup>69</sup>

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<sup>65</sup> FCSA response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>66</sup> Professional Passport response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>67</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>68</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>69</sup> Submission to the 'How Contracting Should Work' Inquiry by Crawford Temple, Professional Passport and PRISM

142. The FCSA are keen to make clear they do and have expelled non-compliant umbrella companies. CEO Phil Pluck gave an example in the oral evidence session:

“We have actually in the last eighteen months discovered one organisation that joined as a member, but actually rather than being non-compliant - because you can actually be non-compliant against our codes, because you're simply inefficient - but you can also be non-compliant because you've been discovered to be operating schemes that we wouldn't approve of. And we did discover one member that was doing that. And once they were discovered, they were 'exited'. But we also know that that organisation continues to employ contractors.”<sup>70</sup>

143. Similarly, with regards to Professional Passport, Crawford Temple stated:

“In the same way we have compliance standards that have to be achieved, if anyone fails any of those compliance standards, then obviously they either don't become a member, or they're removed. I think the important thing to understand is that what's happened over the last, possibly two or three years, is that the requirement for compliance has raised its profile significantly. Many recruitment companies now put a much greater emphasis on a provider's compliance, which in turn means that they'll turn to either of the compliance standards that have become the accepted standards, which is FCSA, Professional Passport generally, but the compliance standard's there.”<sup>71</sup>

144. Similarly, with the REC, Neil Carberry stated:

“Very swiftly, we run a compliance test. The last time we ran our compliance test, we exited 15 members from the REC. We have probably expelled or censured a handful of members over the last few months for cases to do with interaction with umbrellas.”<sup>72</sup>

145. So, non-compliant providers are and have been expelled from the main organisations. However, a key issue identified was that any companies which are expelled from organisations still continue operating, so they may no longer be a member of an organisation with compliance standards, but they are able to carry on operating and more importantly, without any oversight.

146. Many submissions suggested that governmental regulation of umbrella companies is required. This is something that we will come back to in this report, when looking at the issues within the supply chain.

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<sup>70</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>71</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>72</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

## Accountants

147. Although not strictly involved in the supply chain, accountants have professionally advised their clients on the suitability of a particular umbrella company or scheme. The accountant normally receives an introduction fee and may receive ongoing payments whilst the contractor remains in the scheme. Many of the individuals caught by the Loan Charge used umbrella companies recommended to them by these professional advisers.

## 6. What factors have encouraged or enabled tax avoidance schemes?

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148. There are several factors that have clearly led to the promotion, operation and use (in many cases unknowingly) of disguised remuneration schemes.

149. Freelance accountant Kevin Briggs summarises in his submission:

“Tax avoidance has arisen through differences between tax and employment law, a lack of umbrella company regulation, unscrupulous recruitment agents, and HMRC incorrectly interpreting law, and employer’s NIC. Unfair status determination is replacing illegal remuneration schemes, but if fair tax regimes are to be applied to the employed and self-employed the discrepancy between employment and tax law must end. Government should take the advice of the Office for Tax Simplification, not ignore it.”<sup>73</sup>

150. The key factors we have identified in this report are as follows.

### ‘IR35’ and off-payroll/Intermediaries Legislation and the lack of alignment of tax and employment law

151. IR35 legislation has, from the date of its introduction, seen many contractors afraid of non-compliance seeking advice from accountants and tax advisers as to how to continue to operate. Many of these advisers suggested the use of arrangements that would enable them to continue to work in a flexible manner whilst remaining fully compliant with the IR35 legislation. IR35 itself has undeniably been a key factor in many contractors opting to use umbrella companies. As covered elsewhere in this report, the lack of umbrella company regulation and the complexity of schemes (and in some cases their lack of transparency) has caused many people to be caught up in schemes which HMT and HMRC now say “do not work” and left with large, unexpected, unpayable and retrospective tax demands.

152. The reason many find themselves drawn to such schemes is explained by Crawford Temple of Professional Passport:

“Following the introduction of the off-payroll Working Rules for the Public Sector we saw many contractors facing a cliff edge with their net income dropping by as much as 30% overnight. Many of these contractors were unable to deal with this drop and so actively found ways that would soften that impact. They had varying degrees of awareness of the schemes but felt they had little, or no, alternative.”<sup>74</sup>

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<sup>73</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Kevin Briggs, Freelance Accountant

<sup>74</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Crawford Temple, Professional Passport/PRISM

153. Andy Chamberlain describes the clear link between IR35 and people ending up in 'disguised remuneration' schemes:

"I think there's a link between IR35 coming in, announced in '99 and came into force in 2000 and then we saw the bullet break in the tax avoidance schemes following on from that. There was a view when it came in that this was going to be the end of contracting, that we were being forced out of our contracting businesses and to go and take employed roles which people didn't want to do."

"And these schemes appeared to be a sort of safe haven away from them. Now, people actually ran from the frying pan into the fire and they didn't realise quite what they were getting into. They were advised badly. There was lots of mis-selling going on and we had a real problem ever since and particularly in the last few years with the Loan Charge, but I think that that was definitely one driver, and you mentioned complex supply chains."<sup>75</sup>

154. These concerns have also been echoed by Phil Pluck and the FCSA:

"...what is very clear is that some of the stimulus, IR35, etcetera, has created a confusing area for employees, contractors, freelancers, that is allowing non-compliant, illegal operators to operate loan schemes or capital investment schemes, or benefit trust schemes, because the name keeps changing."<sup>76</sup>

155. This is all something that, as Crawford Temple states in his written submission, was predicted in the consultation over the roll-out:

"Some changes in legislation have heightened the use of these schemes, the most recent being off-payroll working in the public sector, which was highlighted in many responses to the consultation."<sup>77</sup>

156. As alas seems all too common with Treasury and HMRC consultations, credible evidence and predictions of the impact of legislation were ignored. In this case, considering HMRC and the Treasury were well aware of the proliferation of loan-based schemes, to press ahead with a policy roll-out when they had been specifically told it would lead to a similar problem for many public sector workers was, in our view, reckless.

157. It also seems clear that it is the attitude of HMRC in interpreting the off-payroll rules, as well as the actual flawed and partial legislation itself that has exacerbated the situation. As Keith Gordon explains:

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<sup>75</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>76</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>77</sup> Submission to the 'How Contracting Should Work' Inquiry by Crawford Temple, Professional Passport and PRISM

“No doubt, the introduction of the IR35 rules ended such abusive cases. But the Revenue’s enforcement of the rules has meant that they have regularly strayed from acting as guard dogs and moved into bloodhound mode. It is that approach that has, in my view, given the IR35 rules a bad name.”<sup>78</sup>

158. The 2017 off-payroll roll-out has itself led to a new wave of workers becoming involved in disguised remuneration schemes, often without any understanding and sometimes actually without any realisation at all. The Loan Charge APPG are now hearing from public sector workers, including NHS health professionals, who have suddenly been faced with a letter from HMRC. Such schemes continue to be marketed today, further encouraged by the IR35 (2017) public sector reforms and advertised via scheme comparison websites.

159. HMRC and the Treasury claim that this legislation and the subsequent amendments to ‘roll-out’ the ‘off-payroll working rules’ to the public sector (in 2017) and now to the private sector (in 2021) are not linked to the proliferation of DR schemes. This is simply **not** credible given the vast amount of evidence sent to the Loan Charge APPG Inquiry, plus the fact that IR35 is specifically mentioned in many adverts for such schemes.

**160. Recommendation: We recommend that the Treasury and HMRC accept the clear and demonstrable role that IR35 legislation has had in the proliferation and use of umbrella companies and related arrangements (some of which have then involved DR schemes) and instead of denying this reality, they seek to implement legislative changes which are both appropriate and fair, thereby creating a much-needed and long overdue certainty for all freelance and contract workers. We believe that this *must* include aligning tax law and employment law. (Key recommendation 3)**

## Tax Complexity

161. One factor mentioned consistently by contractors, freelancers, tax advisers and accountants, is the infamously complex nature of the UK tax system. IT contractor Andy Stokes said:

“In addition, I have become concerned with the endless and continuous changes to the UK tax framework which are supposedly designed to address such avoidance issues, as well as items such as the fundamentally flawed ‘off-payroll’ regulations which are supposedly to introduce fairness into the tax framework. Such items are overly complex, detract from the core activities of business and in my opinion are damaging to the health and well-being of both individuals and the economy in general.”<sup>79</sup>

162. Ralph Bolton, Director, Pre-Emptive Limited makes similar comments:

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<sup>78</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Keith Gordon, barrister, Temple Tax Chambers

<sup>79</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Andy Stokes, IT Freelancer

“We posit that the current contracting environment, bound by IR35 and off-payroll legislation is massively over-complicated, riddled with unforeseen outcomes and actually discourages the behaviours it supposedly wants. We posit that IR35 and off-payroll should be replaced with a legislative framework that actively encourages the behaviours sought by IR35/off-payroll, but does so in a “worker” sense, rather than focussing solely on taxation.”<sup>80</sup>

163. IT consultant Andy Stokes explains how the complexity is a key problem that leads to tax avoidance:

“Tax avoidance is only possible where the taxation framework is less than perfect, and all models and structures implicitly exist within the tax framework.”

“The UK’s ever changing and overly complex taxation system has undoubtedly led to overlap and gaps in the current tax framework. This has created loopholes and uncertainties which unscrupulous parties attempt to leverage in order to make gain, often to the detriment of individuals who do not have the knowledge or experience to understand the pitfalls.”

“Until a simplified, fair, and unified (with Employment Law) tax framework is enacted, one which removes the possibilities of exploitation, then such loopholes and uncertainties will always exist and unscrupulous parties will always seek to take advantage.”<sup>81</sup>

164. The UK tax system is infamously complex and we believe that the Government must now take the hugely complicated nature of this more seriously and initiate a review on how to simplify it, in order to make it easier for HMRC to administer and much clearer for taxpayers and their advisers to understand and comply with.

**165. Recommendation: We recommend that the Government takes more seriously the hugely complex nature of the tax system and commissions a review on how to simplify the tax system, to make it easier for HMRC to administer and much clearer for taxpayers and their advisers to understand. (Key Recommendation 12)**

## The complex and opaque nature of the supply chain and arrangements within it

166. The opaque nature of the supply chain creates an environment which readily facilitates the promotion and operation of disguised remuneration schemes.

167. Maria Hauret has described how contractors are not necessarily aware of the complexities within the supply chain:

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<sup>80</sup> Submission to the ‘How Contracting Should Work’ by Ralph Bolton, Director, Pre-Emptive Limited

<sup>81</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Andy Stokes, IT Freelancer

“From my side, the supply chain itself does come across as overly convoluted. But when you're in the inside looking upwards, you're not necessarily cognizant of it. You just do what it is that needs to be done so that you can do your work and you trust the people around you and move forward. That's all we're there to do, is do one job, not multi.”<sup>82</sup>

168. Caroline Clark explained how it's not clear that schemes are engaging in anything that is wrong:

“...this lack of transparency is what caught a lot of people into disguised remuneration and the Treasury's blaming them for not doing due diligence when in fact what you're saying, it's almost impossible to do due diligence and if you're a low paid, a nursing assistant or a young social worker, you've probably even less ability to work out what the heck's going on.”<sup>83</sup>

169. Caroline Clark has described how things have become much more complicated for contractors:

“The other thing was, was that when I first started, I just dealt with contracting accounting by myself and now it's become so complicated, I have tax advisers, I have legal contract advisers, I have contract insurance, I have, it's just endless. And it's no added value whatsoever.”<sup>84</sup>

170. She also made clear that contractors are pushed into using an umbrella company due to this:

“I think it's got more and more difficult to be into contracting. I used to just look at magazines, find a job, go to see the client and get it or not. Now with an agency I often get interviewed by the agent. I then find that they are sub-agents and another agent, a bigger agent, they've not been amalgamated. I go to them. I then find I go to the client, I then get a contract and then I find that there's some sort of consultancy in the middle. And they want me to use an umbrella.”<sup>85</sup>

171. Phil Pluck, of the FCSA, also believes that complexity is an issue, as well as being a potential sign of non-compliance:

“...complexity should raise suspicions, because an umbrella employer is a fairly simple beast, in that they are the experts in PAYE, they collect your tax, they pass on that tax to HMRC, they pass on National Insurance contributions. And in doing so, they also give the contractor full employment rights. It really is that simple sometimes. And often it is.”

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<sup>82</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>83</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>84</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>85</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

“Complexity should raise suspicion, as far as a contractor is concerned, there is an emergence of all manner of complex things like mini umbrella companies that keep passing one worker to another, to another. And where you start to see that type of behaviour, is where a contractor needs to be educated to ask the right questions.”<sup>86</sup>

172. Andy Chamberlain of IPSE agrees:

“The whole supply chain has become much more confused and so if a client has an interest in knowing what the tax position of the person that they're doing work with, it makes it much harder for them to know that, because they're going through all these different layers of the supply chain. So, I think that...yes, they have fed into the proliferation of these disguised remuneration schemes.”<sup>87</sup>

173. The overly complex – and it seems often deliberately convoluted – supply chain has been summed up best, perhaps ironically, by HMRC, who have tried to use it as an excuse as to why they may not have known about contractors whom they engaged, whilst the contractor was concurrently using a disguised remuneration scheme:

“HMRC does not have a direct contractual relationship with contractors and is not involved in the payment arrangement between suppliers and individual contractor. There is always at least one agency between HMRC and the individual contractor, although in practice this contract can be further sub-contracted, meaning there are multiple agencies between the department and the contractor themselves.”<sup>88</sup>

174. What is peculiar about this is not so much that HMRC are using the complexity as an excuse to cover up their own failings in identifying contractors using those disguised remuneration schemes they later deemed unacceptable (and the embarrassment of this to them) but the fact that HMRC show no desire to tackle this complexity.

175. How can HMRC tell workers to navigate and police this when they themselves are unable to keep their own house in order? This was exposed via Freedom of information requests and the Loan Charge APPG recently published a report on this.<sup>89</sup>

**176. It is clear that the complex and often convoluted nature of the supply chain is at the heart of the environment enabling disguised remuneration schemes. We believe HMRC should be calling on the Treasury to take action to simplify it and clean it up rather than making excuses and blaming individual contractors.**

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<sup>86</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>87</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>88</sup> <https://www.whatdotheyknow.com/request/704840/response/1681781/attach/html/3/FOI2020%2002582%20FOI%20response.pdf.html>

<sup>89</sup> <http://www.loanchargeappg.co.uk/wp-content/uploads/2021/02/Loan-Charge-APPG-report-on-HMRC-use-of-contractors-using-DR-schemes-February-2021-min.pdf>

## Lack of adequate checks from organisations engaging contractors

177. It is clear that many client companies and organisations which engage contract workers have also failed to do proper checks and ensure compliance in the supply chain, nor have they ensured the agencies they use are all fully compliant (by *only* using fully compliant umbrella companies/payment intermediaries).

178. This is an issue picked up in the recent letter from Lord Bridges of Headley following the House of Lords Economic Affairs Finance Bill Sub-Committee oral evidence session:

“We heard concerns that large employers were not sufficiently diligent in ensuring tax compliance within employment supply chains. We were told that many employers who recruited workers through agencies had no scheme or standard for working with agencies who are certified as tax compliant.”<sup>90</sup>

179. Once again, one of the client organisations that has been exposed for not performing adequate checks is HMRC themselves, which is one of the reasons that they were discovered to have been engaging contractors using the very schemes they claim ‘not to work’.

180. As a client who uses contractors, HMRC claim to carry out diligent compliance checks, but these actual checks, undertaken by the UK’s tax authority *itself*, have failed to uncover the use of schemes and reveal the non-compliant providers operating them.

181. In addition, HMRC also say that their approved recruitment agencies have only used approved umbrella companies. This has been shown in a separate FOI request shared with the Loan Charge APPG,<sup>91</sup> which is also referenced on the Loan Charge APPG report on HMRC’s use of contractors. As the report pointed out, there is confusion within HMRC between the FCSA (the sector body offering accreditation) and the statutory Financial Conduct Authority. This is a very odd and troubling error, considering that the FCA has no role in overseeing compliance and that there is no statutory regulation in place.

182. What is perhaps even more troubling is that if HMRC are saying that all their approved suppliers only use compliant umbrella companies and intermediaries, then how come some people who came through this route were using disguised remuneration schemes? This either means that there are FCSA accredited companies who have offered disguised remuneration schemes or that HMRC approved suppliers have used non-accredited umbrella companies and/or payment intermediaries. **This is something that both HMRC and the FCSA should take seriously and together, seek to investigate and resolve.**

<sup>90</sup> <https://committees.parliament.uk/publications/4402/documents/44492/default/>

<sup>91</sup> [https://www.whatdotheyknow.com/request/use\\_of\\_contractors\\_within\\_rcdts#incoming-1651271](https://www.whatdotheyknow.com/request/use_of_contractors_within_rcdts#incoming-1651271)

183. Considering that HMRC themselves have failed to identify contractors working for them using disguised remuneration schemes, in part due to the complexity and opaque nature of the supply chain (as well as their own failures to properly check) then how can they expect others operating in the sector, including contractors, to identify dubious and non-compliant providers? It is therefore imperative that HMRC and the Treasury accept that they need to take action to both clean up and also introduce proper transparency, through legislation, in *all* parts of the supply chain.

### Lack of statutory regulation and non-compliant providers

184. As the report has already described, there is currently no statutory regulation of umbrella companies/payment intermediaries. This allows for non-compliant providers to exist and operate, without even being covered by voluntary codes of practice or standards.

185. Ruth Cadbury stated, in the oral evidence session:

“...in the experience I know where an NHS recruitment consultant in my constituency has lost workers because they don't want to sign up with him, because he's not going to be able to pay them as much, because he does things by the book.”<sup>92</sup>

186. Neil Carberry replied “That is a common experience.”<sup>93</sup>

187. As Phil Pluck of the FCSA explains, this allows those operating schemes to get the attention of contractors, via comparison websites:

“There's an emergence now of comparison websites in the industry, which actually means that a fully compliant legal employment agency of umbrella organisation will always end up at the bottom of those comparative websites, just like the example you mentioned, Chair, because actually the more compliant you are, the more you set it out for a contractor, the less attractive it looks, which is why a compliant umbrella organisation will pay 65% of a contractor's gross, whereas a non-compliant will start to say, "I can get you 85%." And in the current climate where new contractors are entering the market, they don't really understand that 85% is actually impossible to legally achieve.”<sup>94</sup>

188. Loan Charge APPG Co- Chair Ruth Cadbury MP asked if it was possible to tell the difference between reputable compliant and non-reputable umbrella companies. The responses from the two contractors were:

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<sup>92</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>93</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>94</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

189. Caroline Clark responded that she did not believe so:

“No....I would say no. Not unless you really know enough about tax to be able to do that.”<sup>95</sup>

190. Maria Hauret responded that she did not at the time, but only with hindsight:

“I think in hindsight, yes. At the time, no. Because every company offered a different type of structure. I was bought in by the fact that the umbrella company that introduced me to the loan schemes had the accolade ‘Queen’s Counsel approved’ and implies, although not explicitly, HMRC approved.”<sup>96</sup>

191. The Loan Charge APPG have previously stated (including in submissions to Government) that those who promote and operate schemes which are deemed to be forms of tax avoidance should become liable for any tax avoided. We believe that this would stop the promotion and operation of such schemes. Currently, scheme promoters and operators know that the liability will fall on the individual worker so continue to promote and operate schemes with impunity.

### HMRC not using data they already have

192. Since April 2016, HMRC have been collecting data quarterly from recruitment firms, about payments made to umbrella companies for individuals that work via them. This is known as the ‘employment intermediaries reporting requirements’.<sup>97</sup>

193. The purpose of the regulation, according to HMRC, includes to “make sure the right tax and National Insurance is paid by people working through intermediaries”.<sup>98</sup> The data is provided every three months, and a simple reconciliation would immediately help to identify clusters of non-compliance by a payment intermediary for closer inspection. Yet, this does not appear to be done.

194. It is clear from this inquiry – and from the huge amounts of evidence that we have been sent regarding the Loan Charge - that HMRC does not use the information and data it already has. To date, HMRC have not created a system to compare those records with RTI submissions, to enable them to very quickly detect tax avoidance schemes created by umbrella companies that operate using disguised remuneration structures. HMRC could simply identify DR schemes via this method and write to warn taxpayers that they are unwittingly using a scheme which HMRC regard as a form of tax avoidance.

<sup>95</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>96</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>97</sup> <https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm10019>

<sup>98</sup> <https://www.gov.uk/government/publications/employment-intermediaries-reporting-requirements/why-the-new-legislation-was-introduced>

195. Instead, HMRC acts a considerable time (sometimes years) later and then goes after the ‘low-hanging fruit’ of individual taxpayers. Huge amounts of distress could have been avoided had HMRC used the data and information it has and worked more effectively with responsible and willing bodies in the sector to stamp out non-compliant umbrella companies and DR schemes.

196. Crawford Temple explains the data which HMRC have and how this can assist with tackling disguised remuneration schemes:

“In 2013, RTI reporting was introduced providing real time data on all payments made to employees. In 2014, Intermediary reporting was introduced providing quarterly reporting on monies sent by recruiters for the work carried out by their contractors, including the amounts sent to payment intermediaries.”

“The combination of these two sets of data provide HMRC an unique insight to the market, where it is used and interpreted correctly. We believe that providing additional resource in matching data will provide the most effective way of identifying potential DR situations. HMRC has processes in place that must be followed in an enquiry which will extend the time before action can be taken. We support these processes and feel they should be upheld, although they do represent challenges in taking swift action.”<sup>99</sup>

197. Crawford Temple, in the oral evidence session, questioned why HMRC have not connected the two sets of data they already have:

“...what I've never been able to work out, is why the Revenue can't connect those two pieces of data, because all of that complexity would disappear instantly. Because in one hand the Revenue's got the management information that says, "Here's what we as a recruitment company are paying every worker," and they've got all the categories. They can see how they're being paid. One of the categories is the work was being paid PAYE by someone else. And then they've got all the RTI returns where they could instantly see that a recruitment company who thinks they're paying an intermediary who's paying PAYE, isn't. And they would immediately be able to identify loan schemes, disguised remuneration schemes, and anything that didn't correlate on a quarterly basis, and take action on it. And to date, as far as I'm aware, it's never been used for that purpose.”<sup>100</sup>

198. Dave Chaplin of ContractorCalculator/IR35 Shield expresses the frustration that HMRC do have the data, but don't use it:

“Frustratingly, HMRC are sat on all the data they need, sent them to them quarterly by agencies which can be used to detect foul play in a heartbeat, but they are not building the simple systems to match up the data

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<sup>99</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Crawford Temple, Professional Passport/PRISM

<sup>100</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

to their own tax data to identify the issues. Therefore, until HMRC get their act together, the only way to stop it is to border up the holes and stop the mice being able to play.”<sup>101</sup>

199. This point was also made by Crawford Temple in the oral evidence session, going so far as to say that if HMRC had used data they had properly, then the Loan Charge Scandal could have been avoided altogether:

“If we look at the Loan Charge specifically, in theory everyone that was involved in the Loan Charge scheme from 2015, should've been identified by the Revenue, and could've been prevented straightaway. Because they had the information that showed that through the intermediary reporting and through the RTI data. Because there is no correlation between those two bits of data, that allows the space for disguised remuneration to exist. And exist for a long period of time. And what happens is, that data is only checked, I believe, retrospectively as an inquiry. You could be running for two or three years before you're even caught in the headlight, by which time most of these companies have disappeared and the Revenue never catches them.”<sup>102</sup>

200. Phil Pluck of the FCSA agreed and suggested that HMRC should work more closely with the representative organisations:

“That's the nub of the issue here, is HMRC being able to use the intelligence it's got, and work with people like Professional Passport, REC, FCSA, because we are there. We do work with them on an unofficial basis, but actually if we could have a more official relationship, we can do an awful lot more for HMRC.”<sup>103</sup>

201. One umbrella company director has suggested that it is deeply suspicious that many umbrella companies don't share the data they have and that this further exacerbates the problem:

“The lack of transparency offered within the supply chain is frightening and this is where the focus must come from. My company has built a real time system that we provide to our clients in line with the HMRC RTI system. It provides complete transparency and Real Time Information on employers NI, Apprenticeship Levy, employees NI, PAYE tax, Accrued Holiday Pay, Paid Holiday Pay and Full Margin Disclosure, which means we and our supply chain can demonstrate to the penny where these monies have been paid to, and most importantly we are able to send the HMRC RTI submission to our clients as well.”<sup>104</sup>

202. The submission goes on to state that this is not common practice on the part of umbrella companies and asks:

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<sup>101</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Chaplin, ContractorCalculator/IR35 Shield

<sup>102</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>103</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>104</sup> Submission to the 'How Contracting Should Work' Inquiry by small umbrella company (name withheld 6)

“Why? We all could do the same. What are you hiding by not doing this?”<sup>105</sup>

203. We find it inexplicably odd that HMRC don't use the data they have to closely monitor a sector where there are many non-compliant operators, which allows for non-compliant practice to exist and for these operators to do so in the full view of HMRC.

**204. Recommendation: HMRC should immediately address this and must, as soon as possible, properly link and reconcile the quarterly data of employment intermediaries with the Real Time Information (RTI) submissions to quickly detect tax avoidance schemes, then take action to shut them down. This would be an important step in genuinely clamping down on tax avoidance schemes and preventing them from operating in the first place. (Key Recommendation 8)**

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<sup>105</sup> Submission to the 'How Contracting Should Work' Inquiry by small umbrella company (name withheld 6)

## 7. The Supply Chain - the 'Wild West'

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205. As a result of the evidence the APPG has been sent, from contractors and freelancers, but also from the three main representative bodies in the supply chain, from organisations involved in the sector and from agencies and umbrella companies themselves, the key focus of much of this inquiry is necessarily focused on the supply chain itself.

206. Several witnesses have described the supply chain and particularly the many unregulated umbrella companies as the 'Wild West'.

207. In the oral evidence session, Andy Chamberlain of IPSE said:

“On umbrellas, I would say there are compliant umbrella companies out there, but it's a little bit of a Wild West. And that's been a lot of the problem with the Loan Charge issue, because it's a very unregulated area and we've been calling for much better regulation of umbrella companies and that's, if we had had that all along, we may not have quite the same level of problems that we do now.”<sup>106</sup>

208. Dave Chaplin uses the same phrase in his written submission and links this directly to the Loan Charge Scandal:

“Payroll schemes are where the door opens into the wild west of unregulated offerings. Whilst the market attempts to self-regulate via accredited schemes, it's very easy for a worker to end up in something that they didn't realise they got into – for example a loan-based scheme. We saw this in April 2017<sup>107</sup> when around 6,000 workers were reportedly pushed again into schemes. HMRC is currently running a large campaign to prevent similar problems happening in April 2021.”<sup>108</sup>

209. Dave Anderson has described the lack of clarity around the use of umbrella companies:

“The whole idea of using an umbrella is murky to say the least. Responsibilities for health and safety, welfare, professional indemnity etc. are not at all clear. If at the end of the day an IR35 assessment is carried out and you are deemed inside IR35 then the people putting you to work, controlling and supervising you should simply be employing you.”<sup>109</sup>

210. The director of one small umbrella company said:

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<sup>106</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>107</sup> IR35 came into force in the public sector on 6<sup>th</sup> April 2017

<sup>108</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Chaplin, ContactorCalculator/IR35 Shield

<sup>109</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Anderson, Freelance Welding and Materials Engineer

“Many umbrella companies are not and do not even adhere to the general guidance within the Employment Status Manual. Payslips are not itemised, holiday pay is still being rolled up and paid, employment costs are not being requested and passed down the supply chain from the engaging supplier and all this leads to the worst bloodshed of all and that is a complete loss of trust from off-payroll workers and loss of monies that is rightly theirs, the very bloodline that allows us to operate our businesses and it is for them that I write this letter to you.”

“The umbrella Industry has become nothing more than commercial cattle herding; off-payroll workers are told which umbrella company they must use 95% of the time, so that pockets can be lined. They have no choice, and if they do not use one of the umbrella companies they are told to use then they in most cases are told that they will lose the job offer, I know this because we see it every day.”<sup>110</sup>

## Compliant providers losing business to non-compliant providers

211. As the umbrella sector is a high-volume, low-margin business model, it is claimed that the ‘incentives’ in the industry can only be funded by unfair practices such as failing to pay employment costs, holiday pay, taxes, employer NI and other contributions. Compliant umbrella companies who refuse to participate in these agency ‘kickbacks’ claim that they lose business as a result and are being forced out of the market.

212. One umbrella company operator explained how it is exceedingly difficult for compliant and ethical umbrella companies to compete with those offering (and mis-selling) disguised remuneration schemes:

“I am but one person and try as I may to ensure that we are compliant and that we follow everything to the letter of the law, we are a tragic minority and we regularly are not able to compete fairly with our competition because we will not, have not and never will engage in the illegal activities so many of our competitors do, which enables their revenue streams to be so much higher and gives them a financial advantage that a compliant umbrella company just cannot compete with.”<sup>111</sup>

213. Dave Chaplin reports hearing of agencies losing businesses by staying compliant:

“We’ve heard stories of agency owners refusing to entertain dodgy schemes, specifically when off-payroll came in, around April 2017, and due to staying compliant, they lost half their business.”<sup>112</sup>

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<sup>110</sup> Submission to the ‘How Contracting Should Work’ Inquiry by small umbrella company (name withheld 6)

<sup>111</sup> Submission to the ‘How Contracting Should Work’ Inquiry by small umbrella company (name withheld 6)

<sup>112</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Chaplin, ContactorCalculator/IR35 Shield

214. Crawford Temple of Professional Passport describes how some recruitment companies see this as a way of having a commercial advantage, whilst others that reject this lose out:

“There are also significant numbers of recruitment companies that see these schemes, or allowing their contractors to use them, as a commercial advantage. We regularly hear from recruitment companies that are suffering commercially where they apply the rules as intended only to lose significant volumes of business to competitors willing to disregard the same rules. Clear examples of this were provided in responses to the consultation on Employment Intermediaries, false self-employment in 2014. This is still the case today.”

“There are significant financial gains to be had and these arrangements still offer commercial advantages to the companies that allow their use. Failing to address this encourages more companies to adopt the same approach on a ‘if you can’t beat them, join them’. Many of these companies are forced into this approach as without it their businesses may not survive.”<sup>113</sup>

215. One submission from a contractor explained that employment via an umbrella company wasn’t real employment, as in effect any ‘employee benefits’ are paid for from the contractor’s own fees.

“Umbrella companies are used to provide a form of PAYE employment paid for out of a contractor’s fees. It must be understood that this can never be real employment because all benefits are funded by the freelancer’s fees so sick pay, redundancy, holiday pay etc. are effectively meaningless. This is a zero-rights employment scenario, in the long term this isn’t a reasonable choice unless rates are drastically raised to even begin into make it worthwhile.”<sup>114</sup>

216. One problem that has been commonplace with regards to those promoting and operating disguised remuneration schemes is that companies can be set up and closed far too easily, meaning that by the time HMRC takes any action, the companies involved have disappeared. When that occurs, HMRC goes after the contractors who used the scheme, even where (as has happened in so many cases) those doing so had been mis-sold them. Those involved with such schemes and companies are clearly confident that they will not be pursued and that scheme users will be the ones facing payment demands from HMRC. Directors are sometimes found operating a new and similar company. **Until action is taken to stop non-compliant payment intermediaries operating (and being able to offer such schemes) it seems that this is an unjust cycle very likely to continue.**

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<sup>113</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Crawford Temple, Professional Passport/PRISM

<sup>114</sup> Submission to the ‘How Contracting Should Work’ Inquiry by a contractor (name withheld 5)

## Issues in the supply chain other than tax avoidance

217. Submissions to the APPG have reported other dubious, unethical (and in some cases illegal) practices within the supply chain that do not lead to tax avoidance, but are themselves deeply questionable.

218. These include:

- (a) Recruitment agencies demanding ‘kickbacks’ or incentives from umbrella companies for being included on a preferred supplier list or recommended to clients. This then incentivises non-compliant providers (who because of non-compliance have higher margins) to offer large bonuses to gain such access to potential clients.
- (b) Contractors being pushed, and in effect coerced, to use a particular umbrella company or payment intermediary by some recruitment agencies, by only being given the option of *one* umbrella company or payment intermediary. In other cases, contractors are given a limited list of options of umbrella companies/payment intermediaries by agencies and are then expected to use one of them.
- (c) A general lack of transparency when it comes to deductions, costs and fees as well as some recruitment agencies ignoring the legal requirement to provide all workers with a Key Information Document (KID).
- (d) Umbrella companies unlawfully deducting employer’s taxes from contractors’ pay.
- (e) 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.

### (a) Preferred Supplier Lists/Kickbacks

219. Several submissions have indicated that umbrella companies are commonly asked to make what are referred to as “kickback payments” to the recruitment agency before they will be considered as an option for their contractors. These payments are sometimes a one-off fee (we have been given examples of £30,000 and £45,000) to allow the umbrella company to be included on the agency’s Preferred Supplier List. Another common kickback is a rebate for each of the timesheets processed.

220. Dave Chaplin describes the situation and says that these can be as high as half of the contractor’s pay.

“There are also questions around some agencies demanding “kickbacks” or timesheet commissions from payroll schemes, which can be as much as 50% of the fee charged to the contractor. And some agencies have Preferred Supplier Lists (PSLs) and force the contractor to use certain firms.”<sup>115</sup>

221. Crawford Temple of Professional Passport outlined the situation regarding ‘Preferred Supplier Lists’:

“...with PSLs which is Preferred Supplier Lists, agencies often move contractors to umbrella companies. And a lot of the movement to the different umbrella companies is because commission payments are agreed between providers and recruitment companies. And quite often some of those payments are significant to be on a preferred supplier list.”

“And when you look at the maths from a recruitment company's perspective, they've got a simple choice. They can either pay to run their own payroll and have a cost in their business that becomes a cost and reduces their profit. Or they can outsource it all to a provider who would then have to pay because the agency is in control of which providers can be used. So, the provider would have to pay the agency. And some agencies are getting significant amounts of money as return on that. Ultimately, it means that the contractor's paying for that, because it's coming out of the charges that they will pay. And so part of the motivation behind it is if you're running a recruitment company, you can make a significant profit at no cost by operating those schemes.”<sup>116</sup>

222. Crawford Temple goes on to explain, however, that this system does encourage non-compliant umbrella companies, as they will then pay significant fees for introductions to get clients:

“And those, in a way, allow the non-compliant providers a foothold in the market, because we see times where non-compliant providers are paying unbelievable amounts of money for introductions through actual recruitment consultants. That whole practice in itself, can undermine the whole compliance process.”<sup>117</sup>

223. In terms of the sort of fees involved, Chair Ruth Cadbury stated “We've heard figures of up to £400 per contractor”. Crawford Temple replied, “Correct”.<sup>118</sup>

224. The extent of the problem is laid out in the submission from a small umbrella company, who wished to remain anonymous but said:

“This then translates to huge levels of commercial of rebates and payments made to recruitment agencies and businesses. In some cases, and as an example, I have been involved in tenders where the recruitment

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<sup>115</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Chaplin, ContactorCalculator/IR35 Shield

<sup>116</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>117</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>118</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

agency has asked for £45,000 upfront and then £16.50 per person, per timesheet. At our company we charge our off-payroll workers a £20 margin and that is it. The level of monies being passed through to agencies or businesses breed the dishonest approach as there is no other way to pay for it. How can any umbrella company afford those upfront costs, £16.50 per person, per timesheet and have a work force of 150 employees as well as other substantial business costs? It is mathematically and financially impossible unless you are making money from additional revenue streams, such as illegally retaining holiday pay, deducting employers NI or App Levy from the gross payment to off-payroll workers. This does not mention under the table cash payments to recruitment consultants for business to be passed to the umbrella companies.”<sup>119</sup>

**225. We find this shocking as well as wholly unacceptable and believe that a light must now be shone onto the whole supply chain, so that such practices are exposed as part of an exercise to fully clean up the sector.**

### **(b) Contractors being pushed/obliged to use a certain umbrella company**

226. The APPG has received submissions that assert recruitment agencies are mandating the use of a particular umbrella company to the contractor as a condition of employment. In some cases, contract, freelance and locum workers are being pushed to use a specific umbrella company and, in some instances, workers are given no choice as to which umbrella company to use, so the situation facing the worker is effectively ‘take it or leave it’.

227. In the oral evidence session, Loan Charge APPG member Seema Malhotra MP asked:

“I wanted to clarify, just to be clear, do some recruitment agencies recruit and insist that a contractor uses a specific umbrella company? Is there anything that's really pushed like that?”<sup>120</sup>

228. Neil Carberry confirmed that the REC is aware of this:

“We've certainly seen evidence in our professional standards committee of complaints from contractors where that has happened, yes.”<sup>121</sup>

229. Section 5 of the Conduct of Employment Agencies and Employment Businesses Regulations 2003 is very clear and states unequivocally that:

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<sup>119</sup> Submission to the ‘How Contracting Should Work’ Inquiry by small umbrella company - Name Withheld 6

<sup>120</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>121</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

"Neither an agency nor an employment business may make the provision to a work-seeker of work-finding services conditional upon the work-seeker using other services for which the Act does not prohibit the charging of a fee."<sup>122</sup>

230. Yet the inquiry has received reports indicating not only breaches with that protocol, but situations where a contractor has only been able to take or continue in a position if they use a recommended umbrella company. There is also evidence that some recruiters have told contractors they must move to a chosen umbrella from a list, to avoid the forthcoming off-payroll rules. This is all contrary to the law, and section 5 on the Conduct Regulations, which it seems is being wilfully breached on a regular basis.

231. The director of one small umbrella company said:

"Off-payroll workers are told which umbrella company they must use 95% of the time, so that pockets can be lined. They have no choice, and if they do not use one of the umbrella companies they are told to use then they in most cases are told that they will lose the job offer, I know this because we see it every day."<sup>123</sup>

232. Dave Chaplin of ContractorCalculator/IR35 Shield has compared this to the 'Concrete Club' run by the New York Mafia in the 1970s:

"Forcing a contractor to use an overpriced service because it then gives a disproportionate kickback to the agency is a pickpocketing racket, [akin to the "Concrete Club" run by the New York Mafia](#) in the 1970s, where firms were coerced into using overpriced cement contractors in New York in return for labour peace. That said, many agencies and payment intermediaries refuse to engage in such exploitative arrangements."<sup>124</sup>

233. The situation appears to be a particular problem where roles are solely advertised via recruitment agencies, as this is then the only way workers in that sector, wanting to find work, can apply for roles. This is the case when it comes to many public sector workers and even where people have applied for positions through public sector approved recruitment companies, they have still ended up being recommended to use umbrella companies. This is very troubling and needs proper investigation, with any public sector approved recruitment agencies who *have* recommended people to non-compliant umbrella companies and who have put people into tax avoidance schemes, facing both appropriate action and also being struck off any approved list of providers to the public sector.

234. Evidence sent to the Loan Charge APPG, as part of the 2019 inquiry, shows how many public sector workers have been pushed into using umbrella companies and actually coerced into using what turned out to be tax

<sup>122</sup> <https://www.legislation.gov.uk/ukxi/2003/3319/regulation/5/made>

<sup>123</sup> Submission to the 'How Contracting Should Work' Inquiry by small umbrella company - Name Withheld 6

<sup>124</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Chaplin, ContactorCalculator/IR35 Shield

avoidance schemes (with the worker simply not understanding and sometimes actually having no idea that this was case). It is also clear that workers are routinely recommended to use umbrella companies by recruitment agencies or, strikingly in at least one case, by an NHS Trust.

235. A written submission sent to the 2019 Loan Charge Inquiry, from a social worker, who told us the [public sector approved] recruitment consultant advised:

“...that she had a great umbrella company to recommend and that lots of her colleagues and locums were recommending and using them. I had no reason to mistrust my consultant [...] and said that I would chat to them, within minutes I had [a call] from SmartPay advising that [the recruitment consultant] had passed my contact details on.”

“He spoke in detail about how the tax loophole was legitimate and that [SmartPay] were HMRC and IR35 compliant. I asked a number of times how this could be compliant, and was keen to know that I was paying my bit.”

“...I am now concerned that [the recruitment consultant] was in fact financially benefiting from a referral bonus when signposting contractors to SmartPay.”<sup>125</sup>

236. Another written submission to the 2019 Loan Charge Inquiry from a locum doctor actually stated that the NHS Trust he worked for had encouraged him to join:

“Some of the trusts I work with, they knew exactly what was going on, in fact, they actually would encourage us to go via the umbrella route. They’d come to me and say, [name redacted], listen. If you’re going to go PAYE with these guys, I can only pay you so much. If you’re going to go via the umbrella, I can pay you so much more.”<sup>126</sup>

237. A further written submission to the Loan Charge Inquiry was from a nurse who had sought additional agency work and was then not given a choice about how they could be paid:

“I am a nurse. I’ve worked since qualifying in 2003. I am also an agency nurse and work on a week-to-week basis with no contract or guaranteed hours. [...] the agencies I worked with used umbrella companies and I had no option but to use them in order to work.”<sup>127</sup>

**238. It is very worrying that a significant amount of evidence shows that contractors, especially middle and lower paid contractors, are given little or sometimes no choice as to the umbrella company/payment**

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<sup>125</sup> <http://www.loanchargeappg.co.uk/wp-content/uploads/2019/05/Loan-Charge-Inquiry-Report-April-2019-FINAL.pdf> Page 10

<sup>126</sup> <http://www.loanchargeappg.co.uk/wp-content/uploads/2019/05/Loan-Charge-Inquiry-Report-April-2019-FINAL.pdf> Page 10

<sup>127</sup> <http://www.loanchargeappg.co.uk/wp-content/uploads/2019/05/Loan-Charge-Inquiry-Report-April-2019-FINAL.pdf> Page 10

intermediary that they have to use. The APPG believes that this ‘take-it or leave-it’ situation faced by many is unacceptable and one of the major causes of problems. This must be stopped, as part of the proposed regulation of umbrella companies, but also an improved regulation of recruitment companies and indeed advice to end-hirers, including the public sector.

239. **Recommendation:** As well as regulation to stamp out all situations where any worker is pushed or obliged to use a specific umbrella company/payment intermediary, there should be a targeted investigation into cases where a recruitment agency - that is, an approved provider to a public sector organisation, or a public sector organisation themselves - has recommended or obliged workers to use an umbrella company and/or where that worker has found themselves facing HMRC action as a result of being in a disguised remuneration/tax avoidance scheme. At the same time, public sector procurement rules must be tightened to stop any such occurrences happening in future. (Key Recommendation 6).

### (c) A general lack of transparency over deductions and contractor pay

240. One of the common themes in evidence (both to this inquiry and to the 2019 Loan Charge Inquiry) is that there is a general lack of transparency in the sector and in the supply chain when it comes to deductions, fees and costs taken from contractors’ and freelancers’ pay, on the part of both umbrella companies and recruitment agencies. This is even more of a concern when it is hard to understand, other than the demand for ‘kickbacks’ to be on preferred suppliers’ lists, why many umbrella costs for administering payrolls and timesheets are so high. It is clear that whilst many contractors like the simplicity of the umbrella company model, they are not at all clear on what they are actually paying for, what deductions are taken from their pay and what rights they may have (as an ‘employee’ of the umbrella company).

241. This lack of transparency is clearly something that allows malpractice to be hidden and also, as is clear from the Loan Charge Scandal, allows operators of tax avoidance schemes to mis-sell and mispresent their schemes by referring only to vague ‘fees’ and ‘costs’. In some examples sent to the Loan Charge APPG, rogue providers even claim to be paying ‘correct’ taxes on the part of the contractor (whilst taking considerable fees), but doing nothing of the sort, leaving the contractor likely to face even larger demands for tax unknowingly not paid.

242. Since April 2020, recruitment agencies have been required to give all workers who procure work through them a Key Information Document (KID). These documents should show the what the PAYE rate is to the contractor and the umbrella rate. The inquiry has been told that many contractors report not receiving a KID from their agency.

243. The general lack of transparency is a significant problem in itself, as well as a further driver of malpractice and a ready facilitator for tax avoidance scheme operators. Until and unless this is rectified, it is hard to see

HMRC's strategy regarding clamping down on tax avoidance schemes having any effect, if a situation is allowed to continue where rogue providers mis-sell and further mislead workers about 'fees' they are paying.

**244. Recommendation: There needs to be proper transparency and accountability of all intermediaries and agencies dealing with workers' pay. As part of regulating the sector, the Government must 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. As part of this, the situation regarding employer's tax and National Insurance contributions must be clarified, so that any genuine employee is not responsible for paying employers' taxes, which is not only unfair, but is also a form of tax avoidance on the part of the employer, whether that be an umbrella company or client or both. There must also be concerted action, involving Government, HMRC and the recruitment sector, to ensure that agencies do provide Key Information Documents to contractors (and that any non-compliant agency not doing so faces action as a result). (As per Key Recommendation 4)**

#### **(d) Umbrella Companies unlawfully deducting employer's taxes from contractors' pay**

245. One specific issue that arises from this is the deduction of employer's National Insurance and Apprenticeship Levy from the contractors' pay, meaning that the contractor is actually paying the employer's taxes instead of the umbrella company, as the supposed employer. In reality, employer's NICs should be paid by the client company, but this is not generally the case (i.e. client organisations are not, it seems, being asked to pay this on top of contractor's fees). In the case of some large umbrella companies - those with a turnover of more than £3 million - it has been reported that they appear to also be deducting Apprenticeship Levy payments, yet not providing any training benefit to their supposed 'employees', the contractors.

246. As the employer of the contractor, the umbrella company is obliged to make employer National Insurance (13.8%) and Apprenticeship Levy (0.5%) contributions. Yet evidence sent to the Loan Charge APPG has reported that some of umbrella companies have been unlawfully deducting employer's National Insurance contributions from the contractors' agreed fees, meaning that in effect contractors are paying these employers' taxes, which is illegal.

247. This has been described by the director of one umbrella company:

"There are many, many cases raised by off- payroll workers regarding deductions of App Levy and Employers NI from Gross pay...As there has been no independent regulation for our industry the arrogance of these

umbrella companies has got so high that as such, they think they are untouchable, and unfortunately, they currently are and have been.”<sup>128</sup>

248. The issue regarding who is actually paying employers’ taxes raises the fundamental question of whether umbrella companies are genuine employers. After all, the only source of income is contractor remuneration (either direct from the client or paid indirectly via a recruitment agency). So, if this source of income – the contractors’ or freelancers’ pay – is paying the employer’s taxation, then it cannot be legitimately argued that this is genuine employment and is another troubling area of concern, which suggests there must be a better way of structuring contract and freelance working.

249. The APPG has been made aware of a potential legal challenge, ‘Umbrella Reclaim’, seeking to recruit contractors who believe that an umbrella company they have worked for has taken payments unlawfully from them.<sup>129</sup>

**250. We call on all freelance and contract workers and advisers who have experience of and evidence showing any malpractice to report it to the Employment Agency Standards Inspectorate, and to also report it to their own MP in order to present such evidence to the Government and to appropriate Parliamentary Committees, as well as reporting it to the representative bodies, if it involves any of their members.**

251. When it comes to umbrella companies, the confusion over who is paying employer’s taxes highlights the overall uncertainty that exists, with the Government and HMRC not having a simple, approved way for contract and freelance workers to operate and which is why in the end, the Government *must* resolve this underlying issue, as recommended elsewhere.

### (e) Withholding of Holiday Pay

252. Contractors are entitled by law to take actual holiday or to accrue it and take as a payment at the end of the assignment. Yet this inquiry has been sent evidence that contract and freelance workers who use umbrella companies have had holiday pay withheld by their umbrella company, usually covertly, because the contractor or freelancer is not aware that they should be paid it. It’s been suggested that some contracts with some umbrella companies actually contain clauses that if holiday pay is not claimed within the holiday year, it is forfeited by the contractor and retained by the umbrella company. We’ve also heard reports that in some cases, these companies then split the withheld holiday pay with agencies as a reward for pushing contractors to their service. This would be a serious abuse of the system and if confirmed, needs thorough investigation.

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<sup>128</sup> Submission to the ‘How Contracting Should Work’ Inquiry by an umbrella company director (name withheld 6)

<sup>129</sup> <https://www.umbrellareclaim.com/>

253. Andy Chamberlain of IPSE discussed the confusion around this issue in the oral evidence session:

“Now this is where it does get murky, because the umbrellas will say, no, no, no, no, they do actually have rights and they get holiday pay. But the holiday pay is rolled up into their normal amount of pay. So they're not actually getting, it's not like an employee... I'm an employee, I get holiday pay. I go on holiday and I still get paid. It doesn't work like that if you're working via an umbrella company, so it gets complicated.”<sup>130</sup>

254. The submission from an umbrella company that runs full PAYE and CIS payroll models for off-payroll workers has given their view on the extent of the financial transactions involved:

“I estimate that over £1 billion will have been retained and kept by umbrella companies alone in the past 10 years (I have no doubts that if these companies were forensically audited over the last 10-15 years this number may be double or treble the amount). As we all know, it is illegal to keep any employee's holiday pay. Furthermore, these monies, whilst being stolen from the employees by not being paid to them, should have also been subject to tax and national insurance deductions and passed on to the Treasury. By these payments being retained this also results in blatant tax evasion by the umbrella companies in question, where the NI and PAYE contributions have not legally been passed on to HMRC. For the record, one Managing Director when I put this to them said “I know we shouldn't retain the holiday pay, you're right, but everyone is doing it, so why should we be any different.”<sup>131</sup>

255. The Taylor Review looked at the issue of holiday pay and recommended resolving it by allowing contractors to receive, by default, their holiday pay "rolled up".<sup>132</sup> This would prevent accrual and retention by unscrupulous companies.

256. We are aware of a website for NHS contract workers who are trying to get their holiday pay from the umbrella companies that employed them.<sup>133</sup> The Loan Charge APPG believes these claims should be thoroughly investigated.

257. We have also been told that umbrella companies have refused to pay furlough unless contractors waived their right to holiday pay. This is also described by the umbrella company director:

“I have spoken to many, many off-payroll workers who have said that to get their furlough money from their umbrella employer, they had to waive their rights to holiday pay, so in essence blackmailed, just to get paid,

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<sup>130</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>131</sup> Submission to the 'How Contracting Should Work' Inquiry by a contractor (name withheld 5)

<sup>132</sup> Taylor Review, page 47 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf)

<sup>133</sup> <https://savenhsworkers.org/fcsa-holiday-pay-scandal.html>

when it was clearly written in the JRS guidance<sup>134</sup> that holiday pay was to be added on top of the furlough grant money!”<sup>135</sup>

**258. This is all deeply worrying and we believe there must be a proper investigation into the withholding of holiday pay, including if there have also been any issues related to the furlough system and action should be taken against those companies involved in any malpractice. This unacceptable practice also must be stamped out going forward.**

**259. Recommendation: We call for the withholding of holiday pay to be specifically outlawed and at the same time the recommendation from the Taylor Review should also be introduced, allowing contractors to receive, by default, their holiday pay "rolled up". This would prevent the accrual and retention of holiday pay by unscrupulous companies. (As per Key Recommendation 4)**

### Relationship between recruitment agencies and umbrella companies

260. An important question was asked by Loan Charge APPG Co-Chair Ruth Cadbury, who was chairing the session:

“I'm now going to move onto the relationship between recruitment agencies and umbrella companies. Why do we need both? Why do we have to have umbrella companies? You have your payroll for your own staff, so why can't you run a payroll for the freelancers and the contractors? Do recruitment agencies recruit on the basis of insisting that contractors use an umbrella company at all? Does it have to be specific ones? Is this very commonplace?”

261. The main reason for the use of umbrella companies, according to Neil Carberry, is contractor demand. He said in response to Ruth Cadbury's questions:

“First and foremost, our members would say it's usually contractor demand. It's the way people want to work, sometimes very legitimately, they are genuinely working for lots of different contracts, they are working with people agencies, they prefer to have one payroll. Sometimes they've been sold a solution, often there are a range of engagement things that umbrellas do and so that's a push.”<sup>136</sup>

262. He also added that for smaller recruitment agencies, running a large payroll might be a problem:

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<sup>134</sup> Coronavirus Job Retention Scheme

<sup>135</sup> Submission to the 'How Contracting Should Work' Inquiry by an umbrella company director (name withheld 6)

<sup>136</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

“For smaller agencies, I think absolutely not running a substantial payroll is important. Take for example, the recent SSP cover, to do with the pandemic. If you payroll all of your temps yourself, you will not be eligible for small company SSP relief. If you have an arrangement with an umbrella, you would. There are advantages to outsourcing that payroll as well. As well as contractor demand. Most agencies choose to have a preferred list of umbrellas available for people to use. And that is largely because they need to do the due diligence.”<sup>137</sup>

263. Neil Carberry of the REC acknowledges that recruitment agencies can be at fault, but that the main blame is with umbrella companies:

“We are very clear that when agencies are working with third parties, whoever they are, that they should be doing their due diligence and that they need to let some light into that arrangement. If you look at the REC code, at Section 2B it makes an offence to fail to disclose material facts to job seekers. I think there has always been a risk in parts of the industry of agencies perhaps not being clear enough with contractors about some of the risks they are taking on. But the primary failure is on those who are pushing these schemes towards contractors.”<sup>138</sup>

## Follow-up letters to the REC, FCSA, Professional Passport

264. Following the oral evidence session and due to some of the evidence submitted to the inquiry, the Loan Charge APPG decided to ask follow-up questions to what appear to be the three key representative bodies for umbrella companies and recruitment agencies - the FCSA, Professional Passport and the Recruitment and Employment Confederation.

265. Each organisation was sent a letter, asking a series of questions. Those responses received are in Appendix C. The purpose of the follow-up letters was to establish in more detail the extent of non-compliant practices and what each of the three main representative organisations knew about them.

### (a) FCSA Responses to APPG Follow-up Questions

266. As the CEO of the FCSA, Phil Pluck answered the additional questions put to him by the APPG.

267. The letter says that some recruitment agencies insist that contractors register with an umbrella company on the agency's Preferred Supplier List. This is a condition of the contractor taking on work through that agency

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<sup>137</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>138</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

and those who do not comply have to find work elsewhere. This results in contractors having to frequently change their employer.

268. The FCSA say that recruitment agency rebates/kickbacks are common. Umbrella companies must often pay a fee so that they can be included on a recruitment agency's Preferred Supplier List. A fee of £30K is not uncommon. Timesheet rebates are frequently part of an agreement between a recruitment agent and an umbrella company. The agency receives a payment for every timesheet processed (typically £10) in addition to whatever margins they make elsewhere. Some recruitment agency directors have insisted on less visible incentives from umbrella companies as a condition of being an agency supplier. *These have even included fitted kitchens, paid for luxury holidays and pre-paid credit cards for recruitment agency owners or directors.* Umbrella companies who can afford to entertain these types of requests tend to be less compliant organisations who do not necessarily pay all the contractor/employee costs that they should. They state that FCSA members who have said they will not participate in these arrangements have lost business.

269. In the letter they describe this serious problem:

"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."<sup>139</sup>

270. They go on to describe common kickbacks:

"Common incentive/kickback schemes include:

- Timesheet rebates – for every timesheet an agency provides to an umbrella, a small rebate is applied (unofficially) of say £10 which of course boosts the agency's profit margin whilst decreasing the umbrella's 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 (*Preferred Supplier List*). Fees of £30,000 are not uncommon but because it is generally publicly stated the income/outgoing is declared to HMRC."<sup>140</sup>

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<sup>139</sup> FCSA response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>140</sup> FCSA response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

271. We find it extraordinary and troubling that some recruitment agencies are asking for such incentives as those listed in the first two examples, which are wrong and which ultimately must be paid for by contractors, coming from their fees. At worst, some of these practices could even be criminal and if so, should be investigated as such. The Bribery Act 2010 created a new offence under section 7, which can be committed by commercial organisations which fail to prevent persons associated with them from bribing another person on their behalf.<sup>141</sup> In any case, they must be outlawed.

272. The FCSA have admitted that some of its members do pay a fee to be on the preferred supplier list but state that this must be declared by both parties – however, it is unclear who this would be declared to:

“FCSA members do participate in the third element of schemes highlighted and our codes allow this if it is declared by both parties.”<sup>142</sup>

273. On non-compliant umbrellas, the response says:

“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.”<sup>143</sup>

274. The FCSA confirms that some umbrella companies within the sector routinely withhold holiday pay from contractors and make clear that FCSA compliance rules make it clear that this is wrong and that holiday pay must be calculated and attributed in line with legislation. They state:

“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 members for non-compliant practices, I am not aware of any members being expelled for withholding holiday pay.”<sup>144</sup>

275. The FCSA describe the problem of non-compliant umbrella companies running tax avoidance schemes, who compete by advertising the proportion of take-home pay that they can offer. Some offer 80%+ of invoice value

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<sup>141</sup> <https://www.gov.uk/government/publications/bribery-act-2010-guidance>

<sup>142</sup> FCSA response to Loan Charge APPG further questions for the ‘How Contracting Should Work’ inquiry

<sup>143</sup> FCSA response to Loan Charge APPG further questions for the ‘How Contracting Should Work’ inquiry

<sup>144</sup> FCSA response to Loan Charge APPG further questions for the ‘How Contracting Should Work’ inquiry

as take-home pay even though tax rates dictate that between 50-65% is a more realistic figure. They say that these larger percentages are achieved through either the umbrella not paying sufficient tax, NI and other deductions on behalf of its contractors or through complex taxation schemes which inevitably leave the worker exposed to future HMRC liabilities. The FCSA say that only 30% of organisations which apply for FCSA membership are accepted.<sup>145</sup> This means that 70% of the umbrella companies operating are not deemed by the FCSA to be operating compliantly, which shows the true extent of those non-compliant companies operating within the industry. The FCSA say members that have been found not to comply have been expelled.

276. The FCSA have stated that they are unaware of any member that has specified their employees must waive holiday pay to receive furlough payments. Although Government guidance on this has been passed onto FCSA members as it has been released, it has not always been clear and has sometimes appeared inconsistent with information from HMRC, who seem to have been playing catch-up.

277. The FCSA did not directly answer the final two questions asked - whether umbrella companies and recruitment agencies have been litigated against for unlawful deductions of National Insurance contributions and holiday pay and whether they were aware of umbrella companies that insisted contractors must agree to waive holiday pay to receive furlough payments.

## (b) Responses from Professional Passport

278. The CEO of Professional Passport is Crawford Temple and a summary of his responses to the APPG's follow-up letter are shown below:

279. Professional Passport state they are aware that some recruitment agencies have dictated the umbrella companies that contractors must use to ensure supply chain compliance. In the response they state, when asked if this happens:

“Yes. This has become more common as compliance, and the consequences of non-compliance, in the supply chain has taken hold. As new legislation often holds the ability to transfer debts back into the supply chain, companies are taking steps to protect themselves from these risks.”

“Whilst on the surface this could be seen as a positive step, it has also driven some behaviours that we do not condone (see the answer to your question on rebates). In addition to this, workers can be forced to change their umbrella company each time they take on a new contract with a new agency. This diminishes the continuity of employment they benefit from in an employed umbrella arrangement.”<sup>146</sup>

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<sup>145</sup> FCSA response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>146</sup> Professional Passport response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

280. Crawford Temple states that Professional Passport are aware of kickback payments from umbrella companies to recruitment agencies in order to get business from that recruitment agency.

“Yes. I recently wrote an article on this subject.”<sup>147</sup>

“This is something we have never advocated or approved of. If such payments could be banned, we believe it would help improve compliance across the marketplace.”

“As a recruitment company can decide which providers they are prepared to contract with, this puts them in complete control of the provider market and its ability to access workers.”

“As this power has grown and is expected to grow further following the introduction of the off-payroll legislation in April, it has fuelled wider and higher demands for rebates.”<sup>148</sup>

281. The response from Professional Passport goes on to explain why many recruitment agencies do not operate their own payroll, but use an umbrella company or other payment intermediary, which is precisely because it has become a source of (significant) profit for them, as opposed to a cost:

“If a recruitment company operates PAYE for its workers, i.e., engages them directly without a payment intermediary, that holds a cost to their business. They have to employ a team to ‘onboard’ the workers, a team to run and manage the payroll as well as a team to handle HR. This could add up to significant cost to the business. This cost is fixed and so where a recruitment company operates in a sector that has seasonal highs and lows, the education sector being a good example, they must staff the department at a level to cover their normal levels of business which, in turn, means they are overstaffed during the down time periods.”

“Where the recruitment company uses an umbrella provider, they hold none of these costs and do not suffer because of seasonal variations. The rebates agreed provide further motivation as the recruitment company has turned a cost centre in their business into a profit centre and in some cases this pure profitable income can run into many thousands of pounds.”<sup>149</sup>

282. Professional Passport believe that this is a key driver of non-compliance:

“There also seems to be a strong link between these rebates and provider compliance as well as it driving some of the unsavoury aspects of providers’ operations (see answer to withholding holiday pay question).”<sup>150</sup>

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<sup>147</sup> [https://www.contractoruk.com/agencies/agency\\_kickbacks\\_when\\_contractors\\_use\\_their\\_recruiters\\_psl\\_umbrella\\_company.html](https://www.contractoruk.com/agencies/agency_kickbacks_when_contractors_use_their_recruiters_psl_umbrella_company.html)

<sup>148</sup> Professional Passport response to Loan Charge APPG further questions for the ‘How Contracting Should Work’ inquiry

<sup>149</sup> Professional Passport response to Loan Charge APPG further questions for the ‘How Contracting Should Work’ inquiry

<sup>150</sup> Professional Passport response to Loan Charge APPG further questions for the ‘How Contracting Should Work’ inquiry

283. Specifically and also worryingly, Professional Passport report considerable amounts of anecdotal evidence where contractors' pay is funding such arrangements, including through the withholding of holiday pay:

“The level of these payments is hard to justify in the low margin world of the umbrella. There is plenty of anecdotal evidence where providers are using contractors' money to fund these arrangements, i.e., where they have not paid out all the holiday pay entitlement to workers. Unfortunately, the lack of enforcement generally, and specifically relating to holiday pay, has allowed this practice to continue.”<sup>151</sup>

284. Professional Passport is aware that holiday pay is routinely withheld from contracts. The reason for this is that workers' employment contracts often state that any holiday entitlement must be taken within the holiday year or will be lost. Although some umbrella companies will agree with a contractor's request to include a proportion of holiday pay in each pay run, this practice is unlawful and cannot be contractual. The Taylor report recommended that this become the default practice but this was not taken up by the Government. Professional Passport advises several measures to improve the transparency of holiday pay:

“Matthew Taylor also highlighted this in his Good Work Report and suggested that rolled-up holiday pay become the accepted default as most workers selected this, and it lowered the risks of holiday pay being retained by providers. This recommendation was not taken up by the Government.”<sup>152</sup>

285. Professional Passport are aware that some umbrella companies and recruitment agencies have been litigated against for unlawful deductions of National Insurance contributions and holiday pay. Many of these claims are driven by a misunderstanding of the rate being offered as work is not advertised on a consistent basis. Uplifted rates used to pay an umbrella company and PAYE rates used to pay an “employee” contractor are different. In the past, uplifted rates have sometimes been advertised to attract workers without the worker realising that the rate included employment costs. The Key Information Document (KID) which became a requirement in April 2020 has increased the transparency of rates and the basis on which they are offered.<sup>153</sup>

286. Professional Passport is aware that some umbrella companies have specified that their employees must agree to waive holiday pay to receive furlough payments, although are unaware of any Professional Passport members that have done so. Many complaints have related to the basis on which the furlough calculation was made and unfortunately when consulted, HMRC was not always able to provide the required clarity. Ultimately it is an employer's decision on whether to furlough their employees and many umbrella companies decided not to do so.

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<sup>151</sup> Professional Passport response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>152</sup> Professional Passport response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>153</sup> <https://www.gov.uk/government/publications/providing-a-key-information-document-for-agency-workers-guidance-for-employment-businesses>

### (c) Responses from the REC

287. The response gave a useful figure on how many people are estimated to be working via recruitment agencies:

“REC data finds that on any given day, just under 1 million people are out on an assignment via a recruitment agency.”<sup>154</sup>

288. The REC responses did not directly answer the question as to whether there are recruitment agencies who specify which umbrella companies their clients (contractors/freelancers) must use, as part of offering work.

“Although they may have a list of preferred suppliers, of the recruitment businesses we have spoken to, they all say that it is individuals who decide and drive the choice of their umbrella company - and some individuals will select their own umbrella company that is not listed on the agency's PSL. These REC members advised us that they use an online system to provide information on their proposed umbrella companies to individuals, and individuals enter information about their preferred umbrella online as well - thereby ensuring that the recruiter does not influence the decision made by the individual.”<sup>155</sup>

289. Whilst accepting that this may be the position of many recruitment agencies, it does not answer the question as to whether or not the REC is aware of the practice in the sector. It seems clear that there are recruitment agencies that do insist on a certain supplier. It would have been helpful to receive an answer, including whether they believe that any REC members do or have done this. It is rather odd that this was not addressed in the letter from the REC, when Neil Carberry confirmed in the oral evidence session that the REC is aware of contractors reporting that this practice occurs.

290. The response gave the REC's view on 'kickbacks', which it preferred to call 'profit share arrangements' and they claim that these arrangements do not impact 'on wages paid':

“There can be a profit share arrangement between the agency and the umbrella for the umbrella to be their preferred or authorised supplier - but this is by no means universal and does not impact the wages of the individual worker / contractors. Expected pay rates are already documented on the KID - supplied to the individual before their preferred payment method / umbrella company is chosen.”<sup>156</sup>

291. This description by the REC and their understanding of the situation is clearly at odds with other evidence we have heard, including from the FCSA and Professional Passport. In addition, the issue is surely not whether

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<sup>154</sup> REC response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>155</sup> REC response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

<sup>156</sup> REC response to Loan Charge APPG further questions for the 'How Contracting Should Work' inquiry

this practice has an impact on the original wages of the worker/contractor, but that it must be reflected in the fees charged, either to the contractor directly or indirectly, or to the umbrella company (who would then need to reclaim this through their fees). The only source of income to both agencies and umbrella companies is the workers'/contractors' wage, so incentives paid in the chain must in the end come from the money paid to contractors from clients.

292. We would urge the REC to be much clearer in what they regard as acceptable practice when it comes to incentives (which we find deeply questionable) and to have stricter and clearer public guidance on this, including transparent breakdowns of any incentives and fees (from both recruiters and umbrella companies).

293. We find the REC's responses partial and unconvincing, when it is clear from the evidence that there are some recruitment agencies who are a fundamental part of the problem and through incentives/kickbacks open the doors to non-compliant umbrellas, as well as the practice being in itself, surely unethical. We urge the REC to explore this area in more detail and decide what they consider to be the correct way of operating, and to set them out in their membership codes and enforce them.

**294. Recommendation: We request that the REC consider publishing clearer and stronger guidance about what is ethical and acceptable when it comes to the charging of fees for being on preferred supplier lists. We would particularly like to see the REC state that no recruiter, whether a member or not, should ever insist on undisclosed kickbacks. (Key Recommendation 5)**

**295. We also believe it should be mandatory for a recruiter to make explicitly clear, including in writing, if they are recommending any umbrella company or payment intermediary from whom they have received payments, for listing as a preferred supplier or for recommending to workers.**

### Summary of the responses from the three organisations

296. We thank the three organisations for their responses. It is clear from them that there are serious issues of malpractice with non-compliant providers, particularly amongst those not members of one of these bodies, and that the Government must take action.

297. It is also notable that the recruitment agency body blames umbrella companies and the umbrella company organisations blame the recruiters. The different parties in the supply chain all accept there are fundamental issues, but they are all pointing the blame at each other, rather than acting as a whole. This would indicate that regulation is desperately needed. When it comes to agencies, non-compliance appears to be driven by their own commercial interests, and not those of compliant umbrella companies who are pushed to become engaged in incentives and kickbacks to procure clients and income, which then encourages non-compliant providers who

are all too happy to get involved with this, thus allowing them to promote and mis-sell their schemes to contractors.

298. We urge the REC to acknowledge the role that many recruitment companies play in this as drivers of the non-compliant market and to be much clearer and stronger about criticising them, as well as (rightly) criticising non-compliant umbrella companies and payment intermediaries.

299. We urge the FCSA and Professional Passport to very strongly criticise and condemn all the malpractice outlined in this report by (any) umbrella companies, as well as those non-compliant companies directly involved in (mis)selling disguised remuneration schemes. To clean up the whole sector, the stamping out of all such unacceptable practices is also necessary.

300. The REC, the FCSA and Professional Passport have all been running for well over a decade, and (as we think they would readily admit) they have so far been unable to solve the problems together. In our view, this shows that there needs to be intervention to stop bad practice in both parts of the supply chain, and we welcome that all three organisations agree that there should be statutory regulation. This is clearly essential.

**301. We are deeply troubled by the reports we have received about the various forms of malpractice in the sector, involving both umbrella companies/payment intermediaries and recruitment agencies and believe that this must be addressed by both Government and the representative organisations in the sector.**

**302. Recommendation: We call on the Government to announce plans to introduce statutory regulation for payment intermediaries. Considering that the main representative bodies in the sector agree with this, then the Government should proceed as quickly as possible to clean up the supply chain. The ‘wild west’ is clearly where many of the problems associated with DR schemes have occurred. We will later in the report stipulate key practices that should be stamped out or controlled through this regulation. (As per Key Recommendation 4)**

### Are umbrella companies necessary or desirable?

303. Several witnesses have questioned whether umbrella companies are desirable – or indeed necessary - at all. Dave Anderson states in his written submission:

“In a civilised society there should be no need for an umbrella company, either you are an employee or self-employed providing your services as a subcontractor or service provider.”<sup>157</sup>

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<sup>157</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Anderson, Freelance Welding and Materials Engineer

304. Dave Chaplin has questioned why recruitment agencies don't operate their own payroll and questions why umbrella company fees for timesheets are high – and so much higher than those of an outsourced payment intermediary:

“The payroll schemes have a long history, and many used to offer “benefits” by being able to deduct large amount of expenses in a tax-free manner, thereby boosting the take home pay – the industry used to compete on “take home pay”. But now, after the Managed Service Company Legislation in 2007, and the Agency Legislation in 2014, they offer very few benefits to contractors other than to process a timesheet, for which some charge up to £30 per week – which is considerably high compared to what an outsourced payroll provider charges – which is between 5p and 99p a timesheet depending on volume [e.g. see Staffology payroll – from 5p per timesheet]. Why are firms charging over £1,000 a year to a contractor, just to process their payroll?”<sup>158</sup>

**305. We believe there must be full and proper transparency of the basis and justification for all fees charged to contractors, including timesheet fees. As well as regulating to impose this, we would also encourage umbrella companies to be much clearer about why the fees they charge, which appear to be much higher than just the cost of the timesheets, are justified.**

### Drafting error in the Draft Finance Bill relating to payment intermediaries

306. We note that the drafting of the off-payroll legislation changes in Finance Act 2020 contained clauses in section 610 of ITEPA 2003, which would have made umbrellas become “intermediaries” under the off-payroll legislation. The effect of this meant that it would no longer be viable for them to operate. The reason for this is because the umbrella company would become the “intermediary” and therefore the agency (as “fee-payer”) would need to deduct all taxes before passing monies to the umbrella company – thereby making the umbrella company a pointless part of the supply chain. The agency would instead just put the worker on their internal payroll.

307. These changes were delayed for twelve months until April 2021, with Ministers citing the COVID pandemic as the reason for the delay. Following this delay and once it was realised what the implications of the drafting would be in practice, there appears to have been a significant lobbying effort by umbrella companies protesting about this change, against what they claim was (and may have been) an unintended consequence.

308. What is interesting from the point of view of this inquiry is that, whether it was the intent of the Treasury and HMRC or not, this change to the law would have stopped the proliferation of umbrella companies (and

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<sup>158</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Chaplin, ContractorCalculator and IR35 Shield

especially non-compliant umbrella companies and payment intermediaries). Whether it was intended or not, the change to the law would have provided a solution through a huge shake-up of how non-employed workers are remunerated and taxed.

309. It is to be noted that had umbrella companies no longer been able to operate, then agencies would have been required to operate their own internal payrolls for agency workers. Ironically, there are many long-standing organisations to which they could have outsourced this responsibility, including some of the firms who provide this same service to umbrella companies.

310. Following the lobbying, HMRC and the Treasury agreed to look at the situation and proposed that an amendment to the Finance Bill 2021 would be made to change the draft legislation and enable umbrella companies to operate again. This is ironic, considering HMRC understand the unregulated umbrella industry is of major concern and the fact, as referenced earlier in the report, that they have launched a largely unsuccessful campaign to try and stop tax avoidance schemes.

311. The Treasury's intention to make the amendment has been confirmed, to continue to allow umbrella companies to operate, and this has been included in the draft resolutions for the Finance Act 2021.<sup>159</sup> We believe there should have been a more full and proper discussion about this, to understand the issues and to allow the opportunity to discuss and debate the different potential solutions for cleaning up the supply chain and stopping the operation, promotion and mis-selling of contractor disguised remuneration schemes. But no such consultation occurred. This was explained by HMRC in their policy paper published on 3<sup>rd</sup> March 2021 as "Due to time constraints, there was no formal consultation on the technical changes."<sup>160</sup> However, HM Revenue & Customs (HMRC) have worked extensively with stakeholders on the design of the changes to ensure that the rules operate as intended."

**312. Recommendation: We believe that there should be a full and proper debate, during the passage of the forthcoming Finance Bill, on this issue and how best to clamp down on the clear malpractice within the supply chain, including that of some umbrella companies and some recruitment agencies, and how to make the supply chain simpler and more transparent.**

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<sup>159</sup> <https://publications.parliament.uk/pa/bills/cbill/58-01/FinanceDocuments/BudgetResos0321.pdf>

<sup>160</sup> <https://www.gov.uk/government/publications/technical-changes-to-make-sure-Off-payroll-working-legislation-operates-as-intended/technical-changes-to-make-sure-Off-payroll-working-legislation-operates-as-intended>

## 8. Changes and potential solutions to structure contracting and freelancing

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### Review and amend 'IR35' and off-payroll/Intermediaries Legislation

313. One thing that needs to change, to make any progress on this whole issue – including to stop (as oppose to later go after) the promotion and mis-selling of disguised remuneration schemes - is for the Government to finally accept the obvious reality that the IR35 legislation is fundamentally flawed and a significant part of the problem. The concept of “deemed employment” as a tax collection mechanism creates considerable uncertainty for business, resulting in damaging and unintended consequences.

314. Whilst we understand and support the aim of stopping those working as employees from seeking tax advantages for falsely claiming to be self-employed (whether this is driven by engagers or workers or both), the overhauling body of evidence shows that not only has IR35 and the subsequent off-payroll rules not achieved its aim, but it has ironically muddied the waters and unintentionally made it harder, not easier, to define contracting and freelancing.

315. We recommend that the Treasury and HMRC accept the clear and demonstrable role that the 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) and instead of denying this reality, that they seek to implement legislative changes which create tax certainty for freelance workers and are appropriate and fair. We believe that this must include aligning tax law and employment law.

316. We believe that the off-payroll reforms, which are now being rolled into the private sector from April 2021, should be looked at during the passage of the Finance Bill after this year’s budget and for the Treasury and HMRC to consider how best to stamp out the abusive practices outlined in this report. We believe that all ‘inside IR35’ workers should get full rights under all legislation dealing with agency workers, with a clear and transparent right to holiday and sick pay.

317. It is both notable and welcome that the current Chair of the Treasury Select Committee, Mel Stride MP, who was the Financial Secretary to the Treasury and who initially proposed and defended the roll-out of the off-payroll rules to the private sector, has now said IR35 should be scrapped. Speaking at a Treasury Hearing on 21<sup>st</sup> October 2020, he said:

"Leading us all unfortunately to the dreaded IR35, I think we are all agreed this is best abolished as soon as possible." <sup>161</sup>

318. This legislation must be revisited (rather than rolled-out) and then the discussion that needs to happen - to both properly recognise and support professional freelancing and to stamp out the mis-selling and use of disguised remuneration schemes aimed at this group - can take place. That then would lead to the evidence provided to this inquiry and the various solutions proposed, being carefully considered and sensibly debated.

**319. Recommendation: We believe that the off-payroll rules, if they are to be introduced and retained as seems clear they are for now, should be looked at during the passage of the Finance Bill after this year's budget and for the Treasury and HMRC to consider how best to stamp out the abusive practices outlined in this report. (Key recommendation 3)**

**320. In order to ensure that workers are protected, they should not be forced to opt-out of the Conduct of Employment Regulations if they are not working on an 'outside IR35' basis via a limited company. We believe that all 'inside IR35' workers should be offered the choice to be remunerated by a simple payroll operation and get full rights under agency legislation, with a clear and transparent right to holiday pay. We believe this should be done as part of the required umbrella company/payment intermediary regulation. (As per Key Recommendation 4)**

## Align Tax and Employment Law

321. We regret that the Government failed to act, following the Taylor Review that it commissioned. Whilst the recommendations were not all directly relevant to professional contracting and freelancing, the key one of aligning tax and employment law must be implemented.

322. We believe in the principle that people should only be taxed as an employee if they are genuinely employed and if so, should receive employee rights and benefits as well as an employment contract (that abides with employment law).

323. Several witnesses supported this. According to Dave Anderson, Director of Brooke Anderson Consulting Engineers Ltd:

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<sup>161</sup> <https://www.ftadviser.com/your-industry/2020/10/21/mel-stride-calls-for-abolition-of-dreaded-ir35-rule/>

“The principle of being an employee for tax purposes only is quite frankly absurd and forcing people out of their own Ltd Companies into the shady arms of an umbrella is frankly immoral. Surely this was not the intent of the original legislation”<sup>162</sup>

324. IT consultant Andy Stokes stated:

“I believe that whatever method of taxation is utilised then it should be simplified and brought into line with Employment Law, as proposed by the Taylor Review of modern working practices.”

“Any taxation method that is fair, unified with Employment Law and simplified would therefore be an appropriate method, and would help to reduce if not eliminate the proliferation of tax avoidance schemes.”

325. We agree with this conclusion, though accept that the key will be finding agreement on “an appropriate method”. Nonetheless, the principle is a particularly important one and aligning tax and employment law would put right an underlying fundamental flaw with IR35 and associated legislation focusing only on tax and not on rights.

**326. As stated earlier in the report, we call on the Government to accept that it is unfair to have workers who are taxed as employees without having rights or benefits of an employee or recognition in employment law. We urge the Government to take seriously the conclusions and recommendations of the Taylor Review and in particular, believe the Government must take a very simple but hugely significant step in resolving all the issues and problems associated with the lack of proper definition and clarity of contracting and freelancing by aligning tax and employment law, providing certainty for contractors and hirers, and also ensuring that anyone who is taxed as an employee also receives the corresponding benefits. (Key recommendation 2)**

### Making intermediaries/agencies liable for tax deemed avoided by DR schemes

327. The Loan Charge APPG have previously stated (including in submissions to Government) that those who promote and operate schemes which are deemed to be forms of tax avoidance should become liable for any tax avoided. We believe that this would stop the promotion and operation of such schemes. Currently scheme promoters and operators know that the liability will fall on the individual worker, so continue to promote and operate schemes with impunity.

328. The Loan Charge Action Group in their submission support this:

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<sup>162</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Anderson, Freelance Welding and Materials Engineer

“HMRC need to act much sooner in challenging the schemes, if the schemes are found to fail, the liability should fall on the umbrella companies.”<sup>163</sup>

329. Richard Murphy also thinks accountants who recommend schemes should be liable:

“And even if there's a QC statement attached, it must say, "This is not a guarantee from HMRC" or a DOTAS disclosure is not a guarantee. It must say there is a risk that this does not work. And if it doesn't say that, then the accountant should be liable. And so the basis is go back to the professions, stop them self-regulating, impose the proper government regulation on the professions and require them to put in place rules which will catch out the cheats who are not disclosing what they're doing to make their money.”<sup>164</sup>

330. Richard Murphy:

“I'm embarrassed by my own profession. I'm a chartered accountant. I have been for 40 plus years. We all have a cross to bear, that's mine. And we have not acted appropriately with regard to the rogues. I would not sell dodgy activities. I never sold tax avoidance. What there has to be is a proper professional code of conduct. There isn't a proper professional code of conduct in any of the accounting professions at the moment.”

“They are about how the professional owes a duty to their profession, but not to the public. So there has to be a proper code of conduct and the requirement must be that the accountant must, or whoever, must put all the risks face up on the table to the person in question in language that they have a chance of understanding. In other words, there cannot be those hidden risks.”<sup>165</sup>

331. Crawford Temple made the point in the oral evidence session that regulation must not just be for umbrella companies, or non-compliant providers will circumvent the definition, so it needs to be for all payment intermediaries:

“It should be defined as payments intermediaries, because otherwise people will circumvent the definition of an umbrella company.”<sup>166</sup>

332. Phil Pluck of the FCSA agreed and made the point that directors of non-compliant schemes should be responsible if HMRC seeks to go after them:

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<sup>163</sup> Submission to the 'How Contracting Should Work' inquiry by the Loan Charge Action Group

<sup>164</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>165</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>166</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

“There's one thing I'd like to emphasise and that is that regulation next year should not focus on the term umbrella. Crawford is right. It should focus on employment intermediaries. I think regulation should seize the opportunity to start to ensure that these have to be placed within the UK jurisdiction. And once they're in a UK jurisdiction, that upstreaming compliance, that prosecution should be heading up the supply chain to make directors responsible, not someone who's an NHS worker who five years later finds themselves with an impossible tax bill.”<sup>167</sup>

**333. Recommendation: The law should be changed to make agencies/umbrella companies/payment intermediaries liable for taxes later deemed to have been avoided or not paid, if a scheme is designated a tax avoidance scheme. (Key Recommendation 9)**

**334. Recommendation: To extend the period whereby contractors can make a claim for unlawful deductions of tax, or unlawfully retained holiday pay, via an umbrella company to six years - and make directors personally liable. (Key Recommendation 10)**

### New/alternative ways to structure contracting and freelancing

335. As well as the Taylor Report, commissioned, but ignored by the Government, several parties who have contributed evidence to this inquiry have previously proposed alternative models and solutions as to how contracting and freelancing can be properly recognised, structured and remunerated.

336. The central question at the heart of this inquiry – and we believe the way to stamp out the operation and use of unacceptable arrangements (by this professional group of non-employed workers) – is to decide the answer to the question we posed when we first launched the inquiry, which is “How can contractors/freelancers be remunerated in a way that is fair to all parties and avoids them being involved (wittingly or unwittingly) in tax avoidance schemes?”

337. One contractor who gave a written submission outlines the current problem faced by contractors – and that the solution is a simpler status for freelancers, which is a good starting point:

“Most clients won’t accept self-employed structures due to tax and employment rights liabilities. This leaves the limited company option or working under an umbrella company. The limited company arrangement is a “one size fits all” structure designed for huge multinational corporations. Ideally there would be a simpler “freelancer” status that clients would accept and trust not to become liable.”<sup>168</sup>

<sup>167</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>168</sup> Submission to the ‘How Contracting Should Work’ Inquiry by a contractor (name withheld 5)

338. The challenge, of course, is how such a status is defined in law, which it would need to be.

339. Several key organisations and individuals, who have given their views to the inquiry, have proposed solutions.

### Freelancer Limited Company - IPSE proposal

340. In September 2015, IPSE (Association of Independent Professionals and the Self Employed) published a discussion document that proposed a new category of company for contractors and freelancers. The “Freelancer Limited Company” (FLC) would be a normal company formed under the Companies Act that adopts a particular memorandum and articles of association. It would qualify for specific tax treatment subject to meeting certain criteria. These criteria would include entry, ongoing and exit conditions which meant that it would have met the IR35 requirements and was not operating as a tax avoidance mechanism. If an FLC failed to meet this criteria, IR35 rules could then be applied. FLCs would still have limited liability but a simplified and less uncertain system of taxation.

341. Entry criteria would include eligibility for actively trading companies with a minimum level of share capital and run by single shareholders only. Ongoing tests would include annual preparation and sign-off of company accounts, evidence of appropriate costs, a salary that is a minimum proportion of net profits and restrictions on the frequency of dividends. Exit conditions could include a time limit on the freelancer re-entering a FLC structure and a greater tax charge on the return of capital.

342. It is proposed that, for the purposes of simplicity, the taxation treatment would be the same as it is for existing PSCs with business running costs being tax deductible and Corporation Tax paid on net profits.

343. The Freelancer Limited Company structure would reduce administration for both freelancer and HMRC, allow contractors and freelancers to focus on the work they are doing, works within the existing legal system and is simple to introduce without complicating existing tax systems for others.

344. The full IPSE document is available online.<sup>169</sup>

### Limited Liability Partnerships – Tax Research UK Proposal

345. Richard Murphy of Tax Research UK produced a paper in August 2007 that analysed the way in which owners of small limited companies were paying themselves. In his paper, he recommends that there is a change in company law to allow the re-registration of small limited companies as Limited Liability Partnerships

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<sup>169</sup> <https://www.ipse.co.uk/static/43cea20b-c776-4ba9-9df41cc91dd1261b/freelance-company-limited.pdf>

(or LLPs). It also recommends new capital requirements, new surcharges on investment income to reduce payments through large dividends and a levelling of tax rates on income from different sources. It also calls for clear standards for splitting income in LLPs to reduce the risk of legal challenges.

346. According to the paper, these changes would still make freelancing and contracting a tax efficient option but within appropriate constraints. Administration of tax for small business would be reduced whilst the certainty of the operating arrangements would increase. Incentives for tax planning would be reduced so simplifying tax administration and the overall tax yield may rise.

347. In the oral evidence session, Richard explained:

“I think it should be possible to actually register a contracting employment as such. A business that is a contractor. Now there would be conditions attached. I don't think it should be a free-for-all. Obviously, it isn't an opportunity for unscrupulous employers to force all their staff onto the position of being a contractor and apparently offload all their responsibilities. That is obviously not okay.”

“So there do have to be some conditions attached which must be evidenced. But if a person can indicate that they have created an appropriate structure, and I would suggest a new limited liability structure is created for this purpose. That is not a company. The company was created in its current form basically in the 1850s. And you know, it's a little time to move on from that.”

“Fundamentally, create something that looks like an LLP. Make that available to people, make it registrable, make an increased degree of tax disclosure on the sources of income, make a requirement that there has to be some degree of risk bearing by the contractor.”

“Make that registrable, create a tax system that is fair, create a National Insurance environment that is fair, do provide contractual support to those like standard contracting arrangements between these entities and so-called employers, the contractor which have forms of protection built in for both parties and then ensure that there is an effective tax transmission mechanism so that the Revenue are also not cheated by it.”

“So, it has to be that all sides have to be treated fairly, but that requires a registration process of a new type of limited liability entity. Built around an LLP, though. Much more flexible than the PAYE scheme, which is a nightmare in these scenarios.”<sup>170</sup>

348. A summary of his document and full paper is available on the internet<sup>171</sup>

<sup>170</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>171</sup> <https://www.taxresearch.org.uk/Blog/2007/08/09/arctic-systems-moving-small-business-taxation-on-in-the-uk/>

349. Andy Chamberlain agreed that this is an interesting idea worth looking at:

“...we do think that something else should be created as well. We came up with the concept called the freelancer limited company. So, unlike what Richard's talking about, it is actually an incorporated idea. Though the others, there are some others that the OTS, the opposite tax implication came up a little while back. One of them was called SEPA, which I think is for Self-Employment Protected Assets, so basically it's limited liability, as Richard said, but you're basically a sole trader within it. I think that's quite a good idea which is worth exploring as well.”

“The reason why we like these ideas is because it's a more transparent structure. What we have at the moment is a problem where the government say you're not really a company, you're a disguised employee and we're going to hit you with IR35 or whatever else. And people say no, no, I am actually, I'm not an employee. And this "vaguery" around it. So, let's try to create something which actually fits this increasingly popular way of working.”<sup>172</sup>

350. Andy Chamberlain summarises the position – and the current problem very simply and clearly:

“I'm not like a company like that company over there. But I'm not an employee either. I'm a freelancer. Let me find the right identity for me, the right structure. And indeed, let's have a conversation about how we tax that to make sure that everyone feels okay about it. And then we get to move on.”<sup>173</sup>

## Freelancer Tax Code – LCAG Proposal

351. The Executive Committee of the Loan Charge Action Group have proposed that a new ‘freelancer tax code’ should be created for freelancers and contractors so that the individual’s tax can be administered by and within the existing PAYE system.

352. They propose that employer’s NI be replaced by a “freelancer surcharge tax” (for example 10%) which is paid by the engager or end-client and to make allowable freelancer expenses claimable against tax. Employee benefits (sickness, holiday, pension, private health insurance, other employment rights) could then be provided by a Government package or alternatively allowable as tax deductible expenses.

## The challenges with any system

353. Some, however, believe that there is no simple solution. Richard Murphy acknowledges the challenges:

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<sup>172</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

<sup>173</sup> Loan Charge APPG ‘How Contracting Should Work’ Inquiry oral evidence session 15th December 2020

“Where the problems are between what is self-employment and what is actually somebody who is on a freelance contract of employment as such, but there are people who are definitely, genuinely contractors who provide their own equipment, who do prove that they are able to undertake the activity independently. And they're not under the direction and control (*of their client*). And if anything, that's become much more common, of course, because lots of people are now contractors working at home. They aren't in the client's premises. They aren't using the client's equipment. They aren't working under direct control all the time. They are not dependent upon the client's resources. They're not traveling to that as a place of work. They are definitely working at home.”<sup>174</sup>

354. The situation with the Covid crisis has, it seems, made the situation even more unclear according to Richard Murphy:

“So, if anything, the COVID-19 situation has made this issue more ambiguous and made it harder to define where the boundaries are. And that is something that is very relevant to the outcome. To me the answer is that there isn't a solution within the existing frameworks.”<sup>175</sup>

355. Some witnesses don't think there is any one single way in which contracting and freelancing can be structured. Andy Stokes is one of these:

“Then I do not believe that there is any single way in which contractors/freelancers can be remunerated in a fair and consistent way and which totally avoids individuals being involved in tax avoidance schemes. Given this, then in my opinion the following is therefore required:

“(1) Simplification and unification with Employment Law of the tax framework to remove uncertainty and loopholes which can be exploited. When simplification takes place, it is easier for workers to understand the system and not get involved in avoidance schemes.

(2) A simple method for non-employed workers to pay an appropriate amount of National Insurance so that all workers will broadly pay the same taxation. When all workers pay broadly the same taxation, then identification of those outliers who are not, and therefore who may be involved in avoidance schemes will become simpler.”<sup>176</sup>

356. Many in the sector believe that for decades the limited company model has worked well for everyone in the supply chain and could continue to be used - were it not for IR35.

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<sup>174</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>175</sup> Loan Charge APPG 'How Contracting Should Work' Inquiry oral evidence session 15th December 2020

<sup>176</sup> Submission to the 'How Contracting Should Work' Inquiry by Andy Stokes, IT Freelancer

357. As well as this being a strongly held view by many contractors and freelancers who use limited companies, Dave Chaplin also shares this perspective, suggesting instead looking at other ways the Treasury can raise more tax, including the potential of a 'hirer's tax' on client companies:

"The limited company model has worked well for 20+ years. Why fix something that wasn't broken? If Treasury want more money, they can raise taxes, or invent a new one and apply it. Some have suggested a hirer's tax of say 5%. That would be simpler than IR35."<sup>177</sup>

358. He also suggested the key elements of any model:

"Any model for contractors needs to have the following ingredients:

- Certainty (e.g. no "deemed employment")
- Inability for schemes to enter the market
- Tax rates not higher than employment
- Ability to claim incurred expenses"<sup>178</sup>

359. Ralph Bolton of Pre-Emptive Limited has suggested focusing on 'statement to work':

"Off payroll has seen a slight and initial turn towards the "Statement of Work" (SoW), rather than the "Contract". This potentially means contractors are hired for a much more clearly defined project or task, rather than the more traditional "three-month contract" which doesn't specify the work to be undertaken. This possibly enables a better way for companies to have relationships with contractors, much more closely aligned with the intentions of the legislation. That is, companies could sign lengthy contracts with dozens of contractors, but then distribute work amongst them via Statements of Work. Some contractors may see no work at all, others may be constantly engaged. Poor performers would obviously receive less work, or can be contractually terminated altogether if required – all without affecting project timescales or budgets."

"This approach means contractors will behave a lot more like freelancers or the "stereotypical builder" - that is, constantly flitting between jobs, lining up the next as one comes to an end, etc. This would be a marked contrast to any permanent employees working nearby."

"Further, the SoW approach actually helps hirers too. That is, they will have a numerical budget for a project to be completed. If they hire a contractor for "three months", they cannot know if the contractor will work for sixty working days, or take a holiday and only work thirty. Thus, they cannot know how much budget will be spent in that period. This then leaves some spare budget which the hirer then says "okay, extend the

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<sup>177</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Chaplin, ContractorCalculator and IR35 Shield

<sup>178</sup> Submission to the 'How Contracting Should Work' Inquiry by Dave Chaplin, ContractorCalculator and IR35 Shield

contractor for another three months”, only to find they’ve now over-spent because the contractor didn’t take any holidays and worked all the days they could.”<sup>179</sup>

360. Dave Anderson has suggested focusing on limiting dividends to a maximum percentage of profits, for Personal Service Companies:

“As an alternative to wholesale changes to the tax system and compromise between raising revenue and not destroying the flexible and mobile contractor market I would suggest that limiting dividends to a maximum % of a “Personal Service Company’s” profits should be considered making a larger proportion of a contractors remuneration paid as salary. Salary would be subject to income tax and employer’s and employee’s NI contributions.”<sup>180</sup>

361. There are clearly issues and challenges in deciding how best to recognise and structure contracting and freelancing and there is no single obvious solution. Nonetheless, it is clear that the current situation – and legislation – does not work and indeed creates problems and encourages non-compliance. We believe that all these ideas should be explored, properly, in a Government commissioned Taylor-style review, particularly looking at and focusing on professional contracting and freelancing.

362. We note that the Conservative Party’s 2019 General Election Manifesto committed to a review:

“We will therefore launch a review to explore how we can better support the self-employed.”<sup>181</sup>

363. This is something that the current Government will therefore presumably want to deliver in the next Parliament once the Covid pandemic crisis has abated. We believe that this can and should include a full and proper review into professional contracting and freelancing, considering all the options outlined in this report.

**364. Recommendation: We recommend the Government commissions an independent review into professional self-employment, to properly recognise and support these important and increasingly common ways of working and to decide how such working be structured, remunerated and taxed. (Key recommendation 1)**

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<sup>179</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Anderson, freelance welding and materials engineer.

<sup>180</sup> Submission to the ‘How Contracting Should Work’ Inquiry by Dave Anderson, freelance welding and materials engineer.

<sup>181</sup> [Conservative Party’s 2019 General Election Manifesto](#)

## 9. Conclusions and Key Recommendations

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365. It is clear from this inquiry that a proper study of professional contracting and freelancing is both needed and overdue. We hope that this inquiry will lead to this issue being picked up by appropriate Parliamentary Select Committees and the Government, who must act to address the significant issues and problems described herein and to also stop the ongoing proliferation of disguised remuneration and tax avoidance schemes.

366. As much as the Loan Charge APPG supports action (and much swifter and more decisive action) against those who promote and operate such schemes and mis-sell these to workers, simply 'going after the promoters' after they have mis-sold and profited from these schemes (and likely wound-up companies) will not stop this problem. Giving clarity and certainty to professional contract and freelance workers will greatly improve this situation, as well as this clearly being essential if the Government wants to deliver its stated aim of "better supporting" self-employed workers.

These are the key recommendations of this Inquiry:

### Review and amend 'IR35' and off-payroll/Intermediaries Legislation

367. We recommend that the Treasury and HMRC accept the clear and demonstrable role that the 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) and instead of denying this reality, that they seek to implement legislative changes which create tax certainty for freelance workers and are appropriate and fair. We believe that this must include aligning tax law and employment law.

368. We believe that the off-payroll reforms, which are now being rolled into the private sector from April 2021, should be looked at during the passage of the Finance Bill after this year's budget and for the Treasury and HMRC to consider how best to stamp out the abusive practices outlined in this report. We believe that all 'inside IR35' workers should get full rights under all legislation dealing with agency workers, with a clear and transparent right to holiday and sick pay.

**369. Recommendation: We believe that the off-payroll rules, if they are to be introduced and retained as seems clear they are for now, should be looked at during the passage of the Finance Bill after this year's budget and for the Treasury and HMRC to consider how best to stamp out the abusive practices outlined in this report. (Key recommendation 3)**

**370. Recommendation: In order to ensure that workers are protected, they should not be forced to opt-out of the Conduct of Employment Regulations if they are not working on an 'outside IR35' basis via a limited**

**company. We believe that all ‘inside IR35’ workers should be offered the choice to be remunerated by a simple payroll operation and get full rights under agency legislation, with a clear and transparent right to holiday pay. (As per Key Recommendation 4)**

## **Align Tax and Employment Law**

371. We regret that the Government failed to act, following the Taylor Review that it commissioned. Whilst the recommendations were not all directly relevant to professional contracting and freelancing, the key one of aligning tax and employment law must be implemented.

372. We believe in the principle that people should only be taxed as an employee if they are genuinely employed and if so, should receive employee rights and benefits as well as an employment contract (that abides with employment law).

**373. We call on all freelance and contract workers and advisers who have experience of and evidence showing any malpractice to report it to the Employment Agency Standards Inspectorate, and to also report it to their own MP in order to present such evidence to the Government and to appropriate Parliamentary Committees, as well as reporting it to the representative bodies, if it involves any of their members.**

**374. Recommendation: We call on the Government to accept that it is unfair to have workers who are taxed as employees without having rights or benefits of an employee or recognition in employment law. We urge the Government to take seriously the conclusions and recommendations of the Taylor Review and in particular, believe the Government must take a very simple but hugely significant step in resolving all the issues and problems associated with the lack of proper definition and clarity of contracting and freelancing by aligning tax and employment law, providing certainty for contractors and hirers, and also ensuring that anyone who is taxed as an employee also receives the corresponding benefits. (Key recommendation 2)**

## **Review how best to structure contracting and freelancing**

375. It is clear that the confusion caused by the current legislation has meant that there is no clear and accepted way for professional contract and freelance workers to operate. This underpins so many of the problems and issues that have arisen in the sector, including the Loan Charge Scandal.

376. It is time for the Government to accept the reality of the complex and confusing situation involving professional contractors and freelancers, finally acknowledge that these are a driver in the proliferation of tax avoidance schemes and that these important workers and their advisers need certainty and clarity.

377. We have not concluded that any one proposal for structuring professional contracting and freelance working is the right one and that any such conclusion could only be reached after conducting an extensive and focused review which considers the many views of professionals and academics involved in the sector.

378. We do believe, however, that a simple, clear model should be introduced for all professional self-employed contractors and freelancers, whether that be a new form of limited company, a limited liability partnership or a new freelance tax status or tax code - all ideas suggested to deal with the mess of the current situation – along with a pragmatic and sensible solution to ‘the wild west’ of the supply chain, the ongoing, deeply problematic and confused ‘IR35’ legislation and the subsequent off-payroll working rules.

**379. Recommendation: We call on the Government to commission a follow-up to the Taylor Review, to investigate the optimum way in which to structure, remunerate and tax professional contracting and freelancing, in order to implement a solution that works for all and which is fair and transparent. This could be part of the review into supporting self-employed people as promised in the 2019 Conservative General Election manifesto. (Key recommendation 1)**

## The Supply Chain – Payment Intermediaries, Umbrella Companies and Recruitment Agencies

380. The ‘How Contracting Should Work’ Inquiry has found significant issues with the supply chain, described in some quarters as ‘the Wild West’.

381. Unregulated umbrella companies or payment intermediaries can and do facilitate or actively promote tax avoidance schemes to contractors, often with the collaboration of non-compliant recruitment agencies who receive incentives or ‘kickbacks’.

382. The outcome of this whole unregulated mess clearly benefits many umbrella companies and recruitment agencies very substantially, in some cases possibly illegally. As the Loan Charge Scandal has shown, it is the individual contractor, whose own wages (and in some cases, illegally, holiday pay) have been covertly involved in incentives and kickbacks that fuel the whole environment and deliver large profits for the companies involved. These then leave the contractor liable and at risk of ruin, for simply using schemes recommended by professionals and in some cases coerced and pushed into them. In most cases, the actual benefit to the contractors of using these schemes instead of a limited company was negligible.

383. The evidence shows that recruitment agencies routinely recommend the use of umbrella companies as it is financially advantageous for them to do so (by saving the costs of operating a payroll and through demanding incentives for including companies on the preferred supplier list). It is clear that this practice is a big driver in the expanding use of umbrella companies.

384. What is of particular concern and indeed, appears to be illegal, is where recruitment agencies insist on a contractor using a (preferred) umbrella company to get the work on offer, despite it appearing to breach the Conduct of Employment Regulations - "you must use an umbrella if you want this job".

385. The Loan Charge APPG is also concerned at the amount of money that should be paid to contractors but is instead siphoned off and pocketed without the contractor realising, and believes there needs to be much more transparency over this matter.

386. It seems that the reason many umbrella companies charge what appear to be disproportionately high rates for running a payroll is because of recruitment agencies insisting on kickbacks or timesheet commissions of up to 50% of the fee charged to the contractor. This is a very significant additional cost to contractors, coming out of their fees and amount to sums that are not actually justified by what is done for them. The reasons for these huge costs appear to be the unregulated (and in some cases unethical) incentives and kickbacks being demanded by agencies.

387. It is clear that agency 'kickbacks' have been a key driver for the operators of disguised remuneration schemes, as it allows them to pay significant sums to become preferred suppliers, with many recruitment agencies all too happy to accept these payments and turn a conveniently blind eye to the behaviour of the umbrella company and what they are offering. Reports of those who have operated (and are still operating) disguised remuneration schemes paying £400 per contractor, per month, to get on the agencies' books is deeply troubling. This practice should be outlawed.

388. It is also clear that this whole environment is also leading to some umbrella companies withholding holiday pay and not informing the contractor.

**389. A fundamental conclusion of the 'How Contracting Should Work' inquiry is that the unregulated umbrella market is out-of-control, all too often exploiting contractors (even without them realising it) and is also a key reason for tax avoidance schemes operating and being so readily and openly advertised.**

390. The Loan Charge APPG questions why more recruitment agencies themselves don't run their own internal payroll, which for many contract workers could provide a simpler model and one that is transparent and avoids any risk of being placed into tax avoidance schemes. This would simplify the supply chain, improve transparency and ensure all contractors are granted employment rights, as envisaged by the Taylor Review. We believe this should be a much more common (and perhaps mandatory) option offered to contractors, alongside a straight ban on recruitment companies telling any worker that they must use a certain umbrella company or payment intermediary, with a legal requirement for any financial incentives to be declared if they recommend any specific intermediary.

391. If umbrella companies are (genuinely) the right solution for some contractors, then they must adhere to the guidelines set down in a statutory code of practice (recommendation in paragraph 360)

## Statutory Regulation of Payment Intermediaries

392. It is clear that the current system of voluntary regulation and accreditation does not stop non-compliant and rogue operators (both umbrella companies/payment intermediaries and also recruitment agencies), does not stop the operation of tax avoidance schemes and does not stop or prevent other malpractice in the sector.

**393. Recommendation: We call on the Government to announce plans to introduce statutory regulation for payment intermediaries. Considering that the main representative bodies in the sector agree with this, then the Government should proceed as quickly as possible with this in order to clean up the supply chain (the 'wild west'), which is clearly where many of the problems associated with DR schemes have occurred. (As per Key Recommendation 4)**

This must include:

- 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 a specified umbrella company or payment intermediary, to stop workers being pushed or encouraged to opt-out of the Conduct of Employment Agencies and Employment Business Regulation 2003
- To make it unlawful for agencies to receive 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 (if they are not working on an "outside IR35" basis via a limited company (PSC).
- To make it a statutory obligation to quote only PAYE contract rates for temporary worker engagements that are not "outside IR35".
- To outlaw the withholding of holiday pay.
- 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 clarify the situation regarding employer's tax and National Insurance contributions.

## Making intermediaries/agencies liable for tax deemed avoided by DR schemes

394. The Loan Charge APPG have previously stated (including in submissions to Government) that those who promote and operate schemes which are deemed to be forms of tax avoidance should become liable for any tax avoided. We believe that this would stop the promotion and operation of such schemes. Currently, scheme promoters and operators know that the liability will fall on the individual worker, so continue to promote and operate schemes with impunity.

**395. Recommendation: The law should be changed to make agencies/umbrella companies/payment intermediaries liable for taxes later deemed to have been avoided or not paid, if a scheme is designated a tax avoidance scheme. (Key Recommendation 9)**

**396. Recommendation: To extend the period whereby contractors can make a claim for unlawful deductions of tax or unlawfully retained holiday pay, via an umbrella company to six years - and make directors personally liable. (Key Recommendation 10)**

## HMRC must use the data they have

397. Rather than merely providing case studies of people who have ended up in disguised remuneration schemes and belatedly opening tax enquiries on workers who used such schemes, HMRC needs to be far more proactive in identifying all such schemes and clamping down on them. This will prevent such schemes from operating and mis-selling to contractors, freelance and locum workers in the first place.

398. The most obvious way they could do this is by using the data they already have and matching the data sets, as described above, to identify potential tax avoidance schemes.

**399. Recommendation: 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, then take action to shut them down. (Key Recommendation 8)**

## Restricting some roles to Employed Only

400. Following the troubling example of the passenger airline pilots described in this report, it is important now to consider whether there should be certain roles in certain situations where a company can only engage fully employed workers and not self-employed contractors or freelance staff. We believe commercial airline pilots should be on this list.

**401. Recommendation: The Government should examine whether there should be certain roles in certain situations where an employer must engage fully employed workers and not self-employed contractors or freelance staff. (Key Recommendation 11)**

## Reviewing how to simplify the overall tax system

402. The UK tax system is infamously complex and we believe that the Government must now take the hugely complicated nature of this more seriously and initiate a review on how to simplify it, in order to make it easier for HMRC to administer and much clearer for taxpayers and their advisers to understand and comply with.

**403. Recommendation: We recommend that the Government takes more seriously the hugely complex nature of the tax system and commissions a review on how to simplify the tax system, to make it easier for HMRC to administer and much clearer for taxpayers and their advisers to understand and comply with. (Key Recommendation 12)**

## Next Steps/Further Work

404. It is clear that there is a pressing need for further work into this area and for action to tackle the problems identified.

405. With no Select Committee having looked in detail at how to properly define, structure, remunerate and tax professional contracting and freelance working, we would recommend that this is something which is now explored in detail, to resolve the well-documented issues with the various forms of IR35 legislation and with the ongoing lack of proper definition or category for contract and freelance working.

**406. We recommend that the appropriate Select Committee, which would probably be the BEIS Select Committee, undertake a full inquiry into the supply chain and into how best to recognise, remunerate and tax professional contracting and freelancing.**

407. It is also clear that the Government must take action with regards to the malpractice in the supply chain and to do so as a matter of some urgency, especially having pledged to take action previously, but having so far failed to do so.

408. The Government should accept and acknowledge the reality of the complex and confusing situation involving professional contractors and freelancers, and that these are a key driver in the proliferation and use of tax avoidance schemes. These important workers and their advisers need clarity and certainty, as well as establishing statutory regulation and compliance, to drive promoters and operators of tax avoidance schemes, as well as other forms of non-compliance and malpractice, out of the market.

**409. We believe that there should be a full and proper debate during the passage of the forthcoming Finance Bill on this issue, discussing how best to clamp down on the clear malpractice within the supply chain, including that of some umbrella companies and some recruitment agencies, and how to make the supply chain simpler and more transparent.**

**410. We urge the Government to announce, this year, a Government supported independent review into professional self-employment, to properly recognise and support these important and increasingly common ways of working and to decide how such working should be structured, remunerated and taxed.**

Loan Charge APPG  
April 2021

## 10. Appendix A: Oral Evidence Session witnesses

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The APPG held an oral evidence session on Tuesday 19th December. There were two panels, as follows:

### Panel One

- Maria Hauret, Contractor and Loan Charge Action Group
- Caroline Clark, Contractor and Loan Charge Action Group
- Andy Chamberlain, IPSE (Association of Independent Professionals and the Self-Employed (IPSE))
- Richard Murphy, Tax Research UK

### [Transcript of Session 1](#)

### Panel Two

- Neil Carberry, CEO, Recruitment and Employment Confederation (REC)
- Phil Pluck, CEO, Freelancer & Contractor Services Association (FCSA)
- Crawford Temple, CEO, Professional Passport and PRISM Trade Association

### [Transcript of Session 2](#)

## 11. Appendix B: Written Submissions

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[Dave Anderson, Freelance Welding and Materials Engineer](#)

[Ralph Bolton, IT Contractor](#)

[Kevin Briggs, Freelance Accountant](#)

[Dave Chaplin, ContractorCalculator & IR35Shield](#)

[Niall Finucane, Freelance Airline Pilot](#)

[Keith Gordon, Tax Barrister](#)

[Andy Stokes, IT Freelancer](#)

[Crawford Temple, Professional Passport & PRISM](#)

[Loan Charge Action Group](#)

[Name Withheld Submission 1](#)

[Name Withheld Submission 2](#)

[Name Withheld Submission 3](#)

[Name Withheld Submission 4](#)

[Name Withheld Submission 5](#)

[Name Withheld Submission 6](#)

## 12. Appendix C: Follow-up Questions

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FCSA (Freelancer & Contractor Services Association)

- [APPG Follow-up Letter](#)
- [Response](#)
- [Additional email questions and responses](#)

Professional Passport

- [APPG Follow-up Letter](#)
- [Response](#)

REC (Recruitment & Employment Confederation)

- [APPG Follow-up Letter](#)
- [Response](#)

## 13. Appendix D: Supplementary Evidence

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Dave Chaplin of IR35Shield sent in the results of a survey carried out by IR35Shield as supplementary evidence to the inquiry:

[IR35Shield Road Ahead Survey](#)