

## Government consultation on umbrella company non-compliance

In June 2023, the government published a public consultation, requesting input and feedback from industry stakeholders as to how best to regulate the umbrella industry and tackle umbrella company non-compliance.

The ideas and proposals contained within the consultation would, if implemented, have significant implications for agencies (and potentially consultancies who use umbrella companies) by:

- Restricting how agencies utilise temporary workers (of any description);
- Requiring any agency to conduct mandatory due diligence on any umbrellas they might use; and/or
- Making the agency primarily liable, or liable under a transfer of debt, for any tax-related non-compliance by the umbrella.

### 1) Defining umbrella companies in law.

The consultation acknowledges that there is no legal definition for an “umbrella company” at present. In order to regulate umbrella companies, they need to be defined in law. The definition cannot be so narrow that it is easy for an umbrella to re-structure so that it is not caught by the definition, and therefore avoids the subsequent regulation(s), nor so wide as to encompass other types of companies who use permanent employees on secondment to support their customers (such as accounting and law firms etc).

One option being considered is to define an umbrella as a “corporate work-seeker” under the Conduct Regulations who employs an individual worker with a view to them being supplied onto a hirer or client (via an agency).

As a consequence of this definition, recruitment agencies would then be restricted in the ways it can engage any temporary worker. All agencies would therefore be required to engage temporary workers in only 1 of 4 possible ways:

- As a permanent employee of the agency – this option already exists for agencies but is rarely if ever used due to the risks and costs of redundancy, unfair dismissal etc.
- As a PAYE temporary worker of the agency – again, this option already exists and is the most common form of “direct” engagement between an agency and a temporary worker
- As an umbrella company worker – where the umbrella acts as a “corporate work-seeker”
- As a PSC / limited company contractor – again, this option already exists but has become less utilised thanks to the Off-Payroll / IR35 rules enacted in 2017 for the public sector and 2021 for the private sector.

**This proposal would, by implication, mean it would become unlawful for an agency to directly engage sole traders, or use an intermediary to engage sole traders, including any sole traders operating under the Construction Industry Scheme (CIS), and from using a “fee-payer” intermediary for PSC contractors who have been deemed Inside IR35.** This would cause huge

problems for any agency in the construction and/or rail sectors, or indeed any other agency who routinely uses sole traders via an intermediary.

Another option offered by the consultation is to define umbrellas using a 3-part test, where all criteria would have to apply for the company in question to be considered to fall within the definition.

- There must be 2 other businesses in the supply chain in addition to the umbrella company, being the client and an agency
- The umbrella must have a direct contractual relationship with the worker
- The umbrella receives a fee / margin for its services, usually taken out of the rate paid by the agency to the umbrella.

While this definition is certainly preferable to the previous one, it still does not clarify the status of other types of intermediary services (such as CIS and PSC fee-payer options). And there are a number of potential loopholes that the umbrella could implement to avoid the definition (and therefore the subsequent regulation) from applying to them.

## 2) Enforcement of worker rights

While the consultation makes it clear that the government wants to protect worker's rights, there isn't a great deal of detail as to exactly how the government would legislate to ensure those rights are protected and enforceable.

Ideas include the following obligations (as a minimum) to be applied to all umbrellas:

- To pay the worker regardless of whether the umbrella is paid by the agency – this would apply to payment of wages and to holiday pay
- Prevent the umbrella from forcing workers to pay for additional services other than its margin
- Pass on relevant information on its services for the agency to issue a Key Information Document (KID).

The consultation also asks respondents whether the EASI (Employment Agency Standards Inspectorate) could be a suitable body to enforce such regulations if and when enacted, and to what extent any enforcement body should be proactive / reactive when dealing with umbrellas.

## 3) Tackling tax non-compliance

It's clear that this is the main crux of the consultation and the area about which the government is most concerned (no real surprise there!). **The consultation proposes a number of options, all of which essentially put more responsibilities and liabilities on the agency using the umbrella, rather than the umbrella company itself.**

Proposals include:

- Mandatory due diligence to be carried out by any agency using an umbrella company – but without detailed guidance as to exactly what checks should be undertaken, how will agencies know what is "good enough"? Furthermore, the consultation considers extending this obligation to other taxes than only employment-related taxes, such as VAT and / or corporation tax.

- Umbrella is primarily liable for tax non-compliance but the agency becomes liable for that non-compliance if HMRC cannot recover the tax liabilities from the umbrella company directly. While this option mirrors other tax-related legislation (such as the Off-Payroll Working Rules and the Managed Service Company legislation), this seems patently unfair when you consider the large size of some umbrellas and the small size of many agencies.
- The agency must operate PAYE on payments to the umbrella. Essentially the agency remains the worker's "employer" for tax purposes, and makes all the relevant deductions for tax and NICs before it makes any payments to the umbrella company. This seems a frankly farcical option since it would be far easier for agencies to contract directly with the worker under a normal PAYE agency worker arrangement than use this overly-complex option.

#### 4) Summary and next steps

We can all see the direction of travel in terms of likely next steps. Agencies will be required, without doubt, to accept more risks, liabilities and/or uncertainty in their use of umbrella companies in the future. **Agencies will likely become, for all intents and purposes, the "guarantor" of the umbrella company. Some engagement types may even be banned in the future, leading to huge disruption in some industries.**

Despite the government wanting to regulate umbrellas, they're actually intending on further regulating agencies who use umbrellas, expecting that the agencies will force compliance by umbrellas. But no account seems to have been taken of an agency's size, resources or their existing administrative burdens and responsibilities. I believe there are a number of other ways that could achieve better compliance, such as mandatory registration / licencing of umbrella companies and/or implementing a form of withholding scheme (similar to the CIS).

It's important to bear in mind that this is only a consultation. The government may, as a result of feedback, abandon all of the proposed options, or it may progress with only some of them. We also do not know when such proposals (if any) would actually become law. I believe any new legislation will, if and when enacted, result in less use of umbrellas as a whole, so in terms of next steps, I would encourage all agencies to:

- Respond to the [consultation](#) and state your concerns about the suggested options. The government may shelve some or all of the options if they receive overwhelmingly negative feedback. The consultation closes on 29<sup>th</sup> August so you have time!
- Start considering the option of offering in-house PAYE to workers if you don't have this in place already (and that includes making sure you understand all the additional legislation and responsibilities that come with engaging temporary workers directly).
- Keep an eye on your existing umbrella companies – we're likely to see a significant reduction in the use of umbrella companies in the future, so make regular enquiries as to the solvency of the umbrellas you work with.

Feel free to contact me on [bernie@labvolution.com](mailto:bernie@labvolution.com) if you would like any additional information or support.