

Tackling Umbrella Company Non-Compliance

The government has issued draft legislation for new laws taking effect from 6 April 2026. These changes will **make recruitment agencies & consultancies (and in some cases, end clients) liable for any tax non-compliance on the part of an umbrella company.**

The draft legislation only amends current legislation relating to income tax, but the same changes will be applied to national insurance contributions (NICs) as well. Here's a summary of the key changes and what they mean in practice.

Definition of an Umbrella Company

An "umbrella company" for the purposes of the new legislation is any business which:

- carries on the business of supplying labour; and
- employs a worker who is personally providing his or her services to an end client; and
- has a contract with an agency or client to supply the services of that worker; and
- is not owned or controlled by the worker (the worker has less than 5% ownership of the umbrella company).

The legislation doesn't define "agency", so the new liabilities will apply to "any person other than the client" who uses an umbrella company. **The legislation therefore will apply to consultancies and/or labour-only subcontractors just as much as recruitment agencies**, and any references to "agency" also includes any other intermediary who uses an umbrella company. More information on other types of intermediary are covered below (see "Other Intermediaries" section).

Joint and Several Liability for PAYE tax (and NICs)

Agencies who use umbrellas will become **jointly and severally liable** for unpaid PAYE tax and NICs. This means HMRC can pursue and penalise the umbrella company, or the agency, or both. However, the accompanying notes very much suggest that **HMRC will pursue the agency** in the first instance.

Agencies will be liable for non-compliance **even if they're not aware that the umbrella company is not properly deducting PAYE**. This, like a lot of other tax laws in recent years, is a "strict liability" provision with no statutory excuse. Regardless of what you knew, or were told, or how many checks you did - you're liable for their failure to deduct PAYE tax and NICs. No exceptions.

Supply Chain Liabilities

- Where there is one agency and one umbrella company in the supply chain, they are jointly and severally liable (but HMRC has expressed a clear intention to pursue the agency first).
- If there is more than one agency in the supply chain, the agency contracting directly with the client is liable (often an MSP, master vendor etc).
- If an agency is located outside the UK, or is “connected” to the umbrella company (ie the agency and umbrella share the same parent or shareholders), liability shifts to the next UK-resident or non-connected party.
- If there’s no agency in the supply chain, the client and the umbrella are jointly and severally liable.

Other Intermediaries

As mentioned above, “agency” in this briefing includes recruitment agencies, MSPs, master vendors, consultancies and labour-only subcontractors. The definition of “umbrella” also encapsulates PEOs (Professional Employment Organisations) and EoRs (Employers of Record) as well as traditional PAYE umbrella companies.

The draft legislation includes a definition of “purported” umbrella companies. If a company **appears** to be an umbrella company but doesn’t actually employ the worker and/or pays the worker through an alternative mechanism, that company will be treated as an umbrella company for the purposes of the new legislation, and that umbrella will be legally obliged to deduct PAYE tax and NICs etc. And any agency who uses a purported umbrella company will be liable for any non-compliance. This anti-avoidance measure is intended to prevent non-compliant umbrellas structuring their operations so that they fall outside the definition of an “umbrella company” as set out above.

There’s no specific carve-out for CIS intermediaries and/or companies acting as the “fee-payer” under the Off-Payroll / IR35 rules, but we’re assuming at this point they won’t be considered as “purported” umbrella companies since the agency knows they are not acting as a PAYE umbrella. However, it’s important to note that if a company is determined by HMRC to be a “purported” umbrella company, that decision overrides and supersedes the current rules around engaging sole traders and/or PSCs operating Outside IR35.

A question that I hope will be clarified in the coming guidance is whether a consultancy might also fall within the definition of an “umbrella” company (not just being jointly and severally liable as the “agency”). Where an agency (or even an end client?) uses a consultancy to supply workers on a T&M basis and the consultancy employs those workers, or “purports” to employ those workers, it appears they might fall within that definition.

Likely Reactions

- MSPs / master vendors will be limiting their exposure very quickly. If you act as a 2nd tier agency, expect to see new contracts which: (1) prohibit the use of umbrella companies completely; (2) require the 2nd tier agencies to use only umbrella companies selected by the MSP; and/or (3) require the 2nd tier agencies to use an umbrella company that's part of their group (and bear in mind the MSP and umbrella will then be "connected" which will make you, the 2nd tier agency liable for non-compliance – very sneaky! It's already happening with 2 MSPs I know of).
- Some umbrella companies will go bust. Some of those will be non-compliant – so good riddance! – but not all of them. This is an industry which relies on volume and minimal margins, so a significant drop in workers will negatively affect every umbrella, even if they're completely compliant. Be prepared for the fall-out when workers are left unpaid by an insolvent umbrella.
- Some clients might insist that agencies engage all their workers on direct PAYE (ie no umbrella companies), even though the client will have no liability if an agency is sitting in the supply chain. So expect new client contracts to be issued in the coming months.
- Clients might also have a (legitimate) concern with using consultancies on a T&M basis who directly employ their workers, so this might be a challenge for consultancies.
- Some umbrellas are offering PAYE insurance as a way to reassure agencies of their compliance and/or ability to pay any liabilities. If this option is offered to you, just remember that insurance is normally invalid if there's been deliberate non-compliance / wrongdoing, so the insurance might be worthless anyway. The devil will be in the detail of the policy wording.
- Other umbrellas are considering becoming payroll agents authorised by the FCA (Financial Conduct Authority) rather than offering a traditional umbrella service. This could be a viable option, but remember it's your PAYE account they will be managing (ie workers will be paid in your name), which comes with its own risks.

Actions for You to Take

- Implement a strict PSL for umbrellas, unless you're prepared to do a lot of due diligence on any new umbrellas you use. If you already have a PSL, review it before April.
- If you're not already auditing your umbrella companies, you need to start doing that **now**. Regularly request copies of payslips, RTI / FPS reports and BACS transfers so you can see the full payment cycle. You also need to make regular enquiries as to the solvency of the umbrellas you work with.
- Use only accredited umbrella companies (e.g FCSA), but you'll still need to audit them. Accreditation will mean nothing once the new laws take effect.
- Consider offering / expanding in-house PAYE capabilities to reduce your reliance on umbrellas.
- Review your contracts with umbrellas and consider (additional) indemnities or insurance options, but remember, indemnities won't help you if the umbrella company doesn't have the funds to pay you! You should also ensure that umbrellas are required to inform you of any financial difficulties they're facing.

- If you're an MSP / master vendor / 1st tier supplier using 2nd tier agencies or consultancies, you need to decide soon what your approach will be for 2nd tier suppliers using umbrella companies. Remember, you're the agency holding the liability, even though you may not even know that the 2nd tier agency is using an umbrella company, let alone whether they are compliant or not.
- Consultancies should expect some clients to request changes to contracts if they're concerned you might inadvertently fall within the definition of "umbrella", which in turn makes them liable for your tax non-compliance. Ensuring contracts don't require personal service by workers, and/or you're providing more than just "labour" and/or ensuring that you and the client are clear you are not employing the workers will all help to offset potential problems.
- Communicate with workers about upcoming changes if you're going to ask them to move to a different umbrella company once you've implemented / reviewed your PSL.

As always, feel free to contact me on bernie@labvolution.com if you would like any additional information or support.