

# Low Incomes Tax Reform Group – Written evidence (OPR0012)

## 1 Executive Summary

- 1.1 We welcome the opportunity to respond to the House of Lords Finance Bill Sub-Committee inquiry on the implementation of the off-payroll rules in the private sector, and how these rules are working in practice.
- 1.2 We have focused our submission on the questions where we feel we can add most value and which fall into our areas of interest and expertise – namely question 6 (behavioural effects), question 7 (new employment body) and question 8 (promoters and avoidance schemes).
- 1.3 As a result of the new rules (that is, with the tax advantages gone), it is likely that many workers will move or be taken out of their own limited companies and put into umbrella arrangements. We should stress that many umbrella companies adhere to certain standards and are concerned about the welfare of their workers. However, the umbrella sector is unregulated and there are some non-compliant models and practices out there.
- 1.4 One of the outcomes of the public sector changes<sup>1</sup> was a mass shift of contractors into highly aggressive umbrella models, including ones based on loan arrangements. More recently, there has been media coverage of an umbrella withholding holiday pay from workers<sup>2</sup>, the loan charge APPG's<sup>3</sup> report linking umbrella companies to ongoing disguised remuneration (DR) and concerns about the use of mini umbrella companies.<sup>4</sup> Added to the negative practices by non-compliant umbrella companies highlighted in our own recent research report 'Labour Market Intermediaries'<sup>5</sup>, the fact that even more people are now working through umbrella companies, could be a cause for concern.
- 1.5 Notwithstanding this, progress over the question of regulating umbrella companies has been extremely slow. The proposal of a Single Enforcement Body (SEB) which would police umbrella companies from an employment law perspective, seems to represent a natural next step towards a more comprehensive framework of protection for umbrella workers (which includes lower paid agency workers as well as contractors) but there is currently a frustrating lack of detail and in any case, an SEB is not, on its own, sufficient.
- 1.6 Much of the wrongdoing by some umbrella companies is tax driven and therefore lies in HMRC's hands, rather than the SEB's, to do something about. In particular, to protect workers from getting caught up in ongoing DR schemes (often unwittingly), we think there needs to be an urgent refocus on PAYE

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<sup>1</sup> See, for example, 'Nurses & agencies using umbrella loan schemes risk tax bills and prosecution', 1 February 2018:

[https://www.contractorcalculator.co.uk/nurses\\_agencies\\_umbrella\\_loan\\_schemes\\_538610\\_news.aspx](https://www.contractorcalculator.co.uk/nurses_agencies_umbrella_loan_schemes_538610_news.aspx)

<sup>2</sup> As per this BBC Money Box programme: <https://www.bbc.co.uk/programmes/m000tcl7>

<sup>3</sup> <http://www.loanchargeappg.co.uk/wp-content/uploads/2021/04/How-Contracting-Should-Work-Inquiry-Report-April-2021-min.pdf>

<sup>4</sup> <https://www.gov.uk/guidance/mini-umbrella-company-fraud>

<sup>5</sup> <https://www.litrq.org.uk/sites/default/files/files/LITRG-Labour-Market-Intermediaries-Report-2021.pdf>

compliance and enforcement at umbrella company level rather than only focussing on promoters and changing taxpayer behaviour, as per the recent Finance Bill proposals.

## **2 About Us**

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people, and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers, and the authorities.

## **3 Question 6 - What behavioural effects have resulted from the introduction of the new rules in the private sector in terms of the arrangements adopted in hiring contractors?**

- 3.1 The introduction of the off payroll rules has meant that medium and large businesses have become responsible for determining the IR35 status of their contractors.
- 3.2 Historically, IR35 has not been complied with or enforced consistently because the test to see whether someone looks like an employee for the end client essentially sat with the worker's limited company (the Personal Service Company or PSC). Therefore, there was considerable financial benefit to working through a limited company (for potentially all entities in the supply chain), with little risk.
- 3.3 Under the new rules, the end client that a person works for is responsible for determining whether they look like an employee. They must do this with reasonable care and pass the 'status determination statement' (and their reasoning) to others in the supply chain<sup>6</sup>. They must also deal with any disagreements following the status determination. This makes it much more likely that the person will be found to be inside IR35 as opposed to outside IR35 because the decision now rests with a different party in the supply chain, with consequences for them if they get it wrong.
- 3.4 If they are inside IR35, the responsibility for operating PAYE and NICs will move from the worker's limited company to the 'fee payer' – that is, the entity which contracts directly with the PSC (this is usually an agency). The fee payer is responsible for operating PAYE and deducting employee NICs on the fees it pays to the PSC (excluding VAT). The fee payer must also pay employer NICs and, where applicable, the apprenticeship levy<sup>7</sup>.

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<sup>6</sup> <https://www.gov.uk/guidance/april-2020-changes-to-off-payroll-working-for-clients>

<sup>7</sup> <https://www.gov.uk/guidance/fee-payer-responsibilities-under-the-off-payroll-working->

- 3.5 The cost savings that contractors (and others in the supply chain) may have received previously, will have disappeared, so working through a limited company has become much less attractive, especially when you consider the additional administration and complexity that there must now be in supply chains involving limited companies.
- 3.6 Therefore, many contractors will have wanted to, or been asked to, stop working through their own company. Options for such contractors then include: trying to get taken on directly by the end client as an employee or to carry on working 'flexibly', via agencies for example, but under PAYE. This will usually mean that they will need to work through an umbrella company, as agencies do not usually operate PAYE on workers' wages themselves.
- 3.7 From posts that we can see on contractor forums (like the following example), it seems to be the case that many contractors are now working through an umbrella company: 'Hi All. First of all, I need to apologise if this question has been covered a million times. I have read the posts, but it appears everyone's case is different and I would like to ask questions for my unique case. I have been contracting for over 10 years, and only going broolly for the first time as the clientco refuses to engage with contractors using a PSC....'
- 3.8 It is hard to quantify the number of such contractors exactly, however we think it will be significant percentage given the numbers that moved over in 2017<sup>8</sup> and remembering that with the public sector changes, people had the option to move to work in the private sector, which now they don't have. Also, due to cultural differences between the sectors, public sector employers were probably more likely to take people on directly via PAYE.
- 3.9 A contractor working through an umbrella company removes much of the administrative burden and responsibility for end clients and agencies, as the off payroll rules do not apply. Although the financials (whether a contractor is working inside IR35 via their own PSC or working through an umbrella company) should be broadly the same (given that employment costs factor in both), the umbrella company sector is unregulated and there is some worrying non-compliance, especially with workers' entitlement to holiday pay, mini umbrella companies and issues with loan arrangements/DR. The money made/saved through these devices can go some way to restoring the previous PSC advantage (although lower paid agency workers, who may never have used PSCs can also find themselves caught up in umbrella companies that use such devices).
- 3.10 That is not to say that all umbrella companies are non-compliant, there are undoubtedly good, compliant umbrella companies in the marketplace. However, HMRC have recently issued a document 'Check how to reduce your risk of using an umbrella company who operates a tax avoidance scheme'<sup>9</sup> aimed at end clients and agencies, which underlines that there are known issues.

**4 Question 7 - The Government is proposing a new employment body with powers to enforce employment rights, including for those engaged by agencies and umbrella companies. How effective do you think such a**

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[rules](#)

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<https://www.contractorcalculator.co.uk/docs/ContractorCalculatorIR35ReformsSurveyReport.pdf>

<sup>9</sup> <https://www.gov.uk/guidance/agencies-and-other-businesses-using-umbrella-companies-who-may-be-operating-avoidance-schemes>

## **body will be in ensuring workers, particularly the lower paid, are treated fairly?**

- 4.1 It has long been our view that the low-paid require their positions to be protected through effective state enforcement. We therefore think the launch of a Single Enforcement Body (SEB), which would include the regulation of umbrella companies from an employment law perspective, is a step in the right direction to protect umbrella company workers (particularly lower paid ones, who are more vulnerable to exploitation). Regulation would drive away those umbrella companies that do not comply with employment law, for example, around things like holiday pay. As we think they are most likely to be the umbrella companies that are also non-compliant with tax law, there is a potential double benefit.
- 4.2 But it could be years before the SEB is up and running as it will require primary legislation to create it, merging three existing enforcement bodies. Umbrella companies are complex, and issues can have multiple strands, so we suspect it will take time for everyone involved in SEB to get up to speed on current pressing issues.
- 4.3 So far, there has been frustratingly little detail regarding things like funding, resourcing, and the type of powers that the new body will be given. For example, will umbrella companies simply be brought under the scope of the Conduct Regulations<sup>10</sup> even though there are many parts of the Conduct Regulations that are not relevant to umbrella companies? Or will the Conduct Regulations be amended, or some other rules developed?<sup>11</sup> It was disappointing that there were no further announcements in this year's Autumn Budget.
- 4.4 But an SEB, even with the right funding, resourcing, and powers to tackle non-compliant umbrella companies, will not offer a complete solution. This is because a lot of the problems with umbrella companies are tax related not employment law related or cut across both areas - and tax will not be in the remit of the SEB *per se*.
- 4.5 There is nothing to stop HMRC from acting now to combat some current tax abuses affecting workers using certain umbrella companies, including DR. This is a serious problem that isn't just affecting sophisticated contractors but is also spilling over into the lower paid agency worker sphere where workers are more vulnerable. For example, here is a query that we have recently received from a supply teacher: 'Enquiry or comment? (please submit as much detail here as possible): I usually work for different agencies I received a letter from Hmrc to do self assessment not self employed but they claimed I have been involved in tax avoidance scheme... as far as I am aware I get paid through (umbrella company). I have done nothing wrong but have been charged £13000.00 for not filling. I have called Hmrc several times asking them to explain but was told they don't know anything about it I ask a lawyer to write to them but they said its my responsibility to deal with the matter. I am stresses really don't what I can do.'

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<sup>10</sup> <https://www.gov.uk/government/publications/conduct-regulations-2003-guidance-for-employment-agencies-and-employment-businesses>

<sup>11</sup> As discussed further here:

<https://mediaserver.responsesource.com/mediabank/46038/inniaccounts/UmbrellacompaniesCallforRegulation140521.pdf>

- 4.6 Some of these workers are unaware that they are in any DR scheme as the motivation and benefits of operating such a scheme can sit with others in the labour market supply chain<sup>12</sup>. Others may have only a limited understanding of what is happening with their pay or may feel compelled to accept the arrangements as they need the work.
- 4.7 Underlying a DR scheme is a failure to operate PAYE correctly on behalf of the umbrella company employer. The PAYE regulations say that in most instances HMRC should pursue the employer for PAYE underpayments<sup>13</sup>. If HMRC take that action against the employer, our understanding is that in most case the employer will then have a right of action against the employee which - if successful - will end up with the employee being in the same position as if the correct deductions had been made in the first instance.
- 4.8 Yet HMRC's position seems to be to recover underpaid amounts from the employee<sup>14</sup>. We do not think it is for HMRC to make this shortcut straight to the employee – the PAYE regulations must be applied and then it is up to the employer to take any action against the employee that they see fit. Recovering amounts from workers also removes the incentive for the umbrella companies to stop using these schemes to pay people and the cycle continues, impacting workers lives and damaging the reputation of our tax system in the process.
- 4.9 HMRC action has, so far, not been very effective for low paid agency workers put into DR schemes via umbrella companies. As such, separate to any work going on around the SEB, we urge HMRC to act against DR – and before the current situation leads to a repeat of the loan charge situation.

## **5 Question 8 - How successful will the draft Finance Bill proposals for earlier publication of information about promoters and avoidance schemes be in protecting individuals from being drawn into such schemes?**

- 5.1 The proposals are bolted on to a regime that was designed to tackle traditional tax avoidance. Yet, we understand from HMRC's own data that around 98% of tax avoidance is now DR based<sup>15</sup>.
- 5.2 The DR arrangements we see today are basically a variation on the theme of an umbrella company worker being paid a minimal amount of taxable income, topped up with a purportedly non-taxable element (whether it be loans, investment payments, advances, grants, loans, credits etc.). They do not seem to involve particularly sophisticated or convoluted planning – those umbrella

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<sup>12</sup> At the lower end of the income scale, the workers themselves often do not benefit or only benefit by a small amount – often small enough that it is not obvious that there is anything untoward. We explain the situation further in our news piece: <https://www.litrg.org.uk/latest-news/news/210527-received-a-letter-from-hmrc-tax-avoidance>

<sup>13</sup> The relevant regulations can be found here: <https://www.legislation.gov.uk/ukxi/2003/2682/contents/made>

<sup>14</sup> See for example here: [https://taxavoidanceexplained.campaign.gov.uk/?utm\\_source=govuk\\_facts&utm\\_medium=refferal&utm\\_campaign=upstream](https://taxavoidanceexplained.campaign.gov.uk/?utm_source=govuk_facts&utm_medium=refferal&utm_campaign=upstream) 'If you are found using a tax avoidance scheme, you'll have to pay the tax that is legally due, plus interest, and you may have to pay a penalty'.

<sup>15</sup> <https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk>

companies involved seem to be designating a portion of otherwise taxable earnings as a non-taxable payment, with little or no paperwork to support the 'planning'. While some umbrella companies may be doing this as part of a bigger avoidance supply chain, others may have simply seen an opportunity to get an advantage in the marketplace, casually introducing such schemes in house without any real 'promoter' behind them.

- 5.3 The evidence that LITRG (and TaxAid<sup>16</sup>) have in terms of lower paid agency workers presenting with DR issues, as alluded to previously, suggests that some umbrella company workers are being paid through DR schemes with no real knowledge or awareness of this. The temporary labour market is buoyant, and the industry is worth billions. DR arrangements mean umbrella companies (who otherwise operate with narrow profit margins) can make a huge amount of money from the amount they turnover. So, it would not be surprising if this was now a significant driver of the DR problem as opposed to taxpayers 'being in the market' for schemes.
- 5.4 Whilst there are undoubtedly still people who have an appetite to use tax avoidance schemes and who make an active decision to use one, we do not believe this is the 'norm' any longer. We are concerned that HMRC does not appreciate this fully and consequently their strategy of focussing on promoters and changing taxpayer behaviour, will fail to be effective.
- 5.5 As a result, in our view, there is now a strong case for decoupling the DR schemes from HMRC's other efforts and presumptions in tackling tax avoidance, and for HMRC to explore alternative strategies.
- 5.6 There are other entities in the supply chain that have a role and some responsibility that HMRC could target, which would be potentially quicker, easier, and more effective at clamping down on the DR problem. For example, as alluded to previously, HMRC could take action at employer level (so against the umbrella companies) for failure to operate PAYE correctly. However, this does not appear to be happening in practice, which is a missed opportunity to stop this type of DR usage<sup>17</sup>.

*11 November 2021*

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<sup>16</sup> [www.taxaid.org.uk](http://www.taxaid.org.uk)

<sup>17</sup> We make further suggestions about what HMRC should do about DR in our response to the consultation on tackling promoters of tax avoidance: <https://www.litrg.org.uk/latest-news/submissions/210601-clamping-down-promoters-tax-avoidance>