

Umbrella companies: Why agencies and employers should be banned from using them



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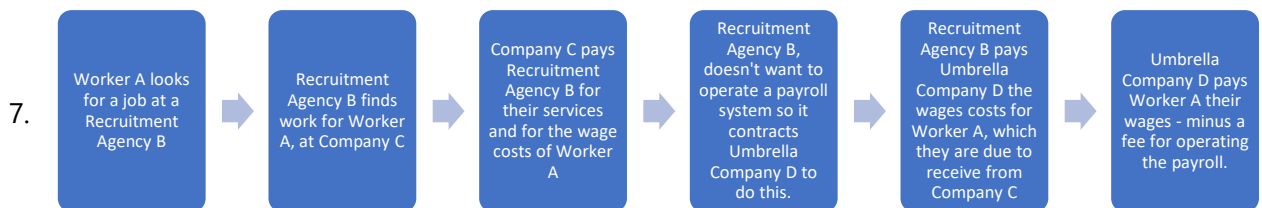
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Report summary

1. Umbrella companies are increasingly being used by recruitment agencies to pay and employ agency workers.
2. People working under these arrangements experience a multitude of problems ranging from a lack of transparency over core terms and conditions to unwittingly becoming embroiled in fraudulent tax arrangements, with serious financial consequences.

What is an umbrella company?

3. An umbrella company is essentially a payroll company. They are used by recruitment agencies to operate a PAYE (pay-as-you-earn) system for the agency workers that they find work for.
4. In many cases, the umbrella company will also employ the agency worker, with the agency workers becoming "employees" of the umbrella company.
5. Freelancers/contractors also use umbrella companies to manage their pay and tax responsibilities. If they use a recruitment agency to find work, the agency may insist they use a particular umbrella company. If they find their work directly from end clients, the end client can often insist that the contractor uses an umbrella company.
6. The diagram below is an example of how a worker might come to use an umbrella company:



8. The diagram above illustrates how the use of umbrella companies makes working lives unnecessarily complicated. If Worker A has a problem with their pay, their holiday leave, or with their tax contributions, they have to speak to the Umbrella Company D, not the organisation that they do work for, Company C, or their recruitment agency, Agency B.
9. Umbrella companies do not carry out a traditional, outsourced payroll function. A recruitment agency doesn't pay an umbrella company for its payroll services. In many cases the umbrella company will pay a fee, per worker, to the recruitment agency to

carry out the payroll services. Research¹ shows these kickbacks range from £5 -£15, on average. But they can be considerably higher.

10. This raises a vital question. If an umbrella company is not paid by the recruitment agency for the payroll services it provides, then who does pay for this service?
11. The worker pays for it.

What problems do umbrella workers face?

12. Unions have reported that the following problems frequently arise:
 - Workers face misleading and unfair deductions from pay. An agency worker using an umbrella company will often not receive the pay rate advertised by the agency. Umbrella companies deduct their operating costs from an agency worker’s pay. Payslips are often indecipherable.
 - Breaches of holiday leave and pay entitlement are widespread, with umbrella companies preventing workers from taking their holiday.²
 - Large proportions of agency workers working under umbrellas do not receive the Key Information Document they have been entitled to since April 2020.³
 - The use of umbrella companies fragments the employment relationship. Workers are not sure who to speak to resolve problems and can be passed from pillar to post when trying to sort out their issues.
 - It’s been widely reported that workers can become unwittingly embroiled in tax evasion schemes, operated by the umbrella company. This has had tragic consequences for a number of workers.⁴
 - There is no proper regulation of the sector. Labour market enforcement bodies do not regulate umbrella companies. This is despite the government accepting a recommendation from the Taylor Review into Modern Working Practices, that enforcement of umbrella companies should be stepped up.
13. The problem was summed up in the recent report from the Loan Charge All-Party Parliamentary Group⁵:

“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.”

¹Temple, C. (Dec 2020). “Agency kickbacks: when contractors use their recruiter’s PSL umbrella company”, Contractor UK.

² (20 March 2021). “Homeowners speak out on gagging clauses”, Money Box, BBC.

³ Ibid. 3

⁴ (March 2020). “Loan charge: MPs in ‘fraudsters’ row with HMRC”, BBC.

⁵ (April 2021). “How Contracting Should Work”, Loan Charge All-Party Parliamentary Group.

14. The use of umbrella companies is growing fast. 600,000 agency workers use umbrella arrangements. It's estimated that 50 per cent of agency workers are handed to umbrella companies to be paid.⁶
15. Unions firmly believe that umbrella companies do not carry out a necessary function in the labour market. Recruitment agencies and end clients should be responsible for paying and employing their umbrella workers.
16. The TUC believes that umbrella companies should be banned. This would improve accountability in supply chains and force recruitment agencies to take responsibility for the welfare of their agency workers.

⁶ (March 2021). "Labour Market Intermediaries", Chartered Institution of Taxation.

Full report

Union campaigns and research into umbrella companies

17. Unions have campaigned against exploitative umbrella companies for the best part of a decade.
18. In 2014, UCATT, now part of Unite the Union, published a report about umbrella companies operating in the construction sector and called for employment agencies to employ workers directly, not via umbrella companies.⁷ In the same year, Frances O’Grady, TUC General Secretary spoke at a UCATT/Unite parliamentary lobby to call for exploitative umbrella companies to be banned.⁸
19. Congress motions passed by TUC Congress from 2014⁹ and 2020¹⁰ highlight the problems with umbrellas and the strength of feeling amongst trade union members across the country.
20. The TUC commissioned the Chartered Institution of Taxation to carry out in depth research¹¹ into the nature and scale of labour market intermediaries and the impact on workers. This technical report published earlier this year provides useful information about how umbrella companies operate, why they are used by recruitment agencies and freelancers and the implications for workers who use them.
21. The key findings from the report were:
 - Umbrella companies cause a multitude of problems for workers, ranging from confusion and misunderstanding about who the worker’s employer is, to unwittingly embroiling workers in tax avoidance schemes with tragic consequences.
 - There is a lack of effective regulation in the sector. There are a few voluntary regulatory umbrella associations. But there is no independent, regulatory authority setting, monitoring or enforcing standards.
 - The scale of the problem was larger than we anticipated. Half of agency workers are estimated to be subject to umbrella arrangements. There are approximately 1 million agency workers, working in the UK on any given day. And the use of umbrella companies is growing.
 - Potential benefits for workers were largely theoretical. Despite many umbrella companies being employees of the umbrella company, they didn’t experience any of the “employee” entitlements such as maternity leave and pay, redundancy pay, unfair dismissal protections and pay between assignments.

⁷ Elliott, J.(2014). “The Umbrella Company Con Trick”, UCATT union.

⁸ O’Grady, F. (Nov 2014). “UCATT & Unite lobby of parliament against umbrella companies”, TUC.

⁹ (Sept 2014). “Congress 2014 decisions on motions”, TUC.

¹⁰ (2020). “Motion 48 Supply teachers and umbrella companies”, TUC.

¹¹ Ibid. 6

What is an umbrella company?

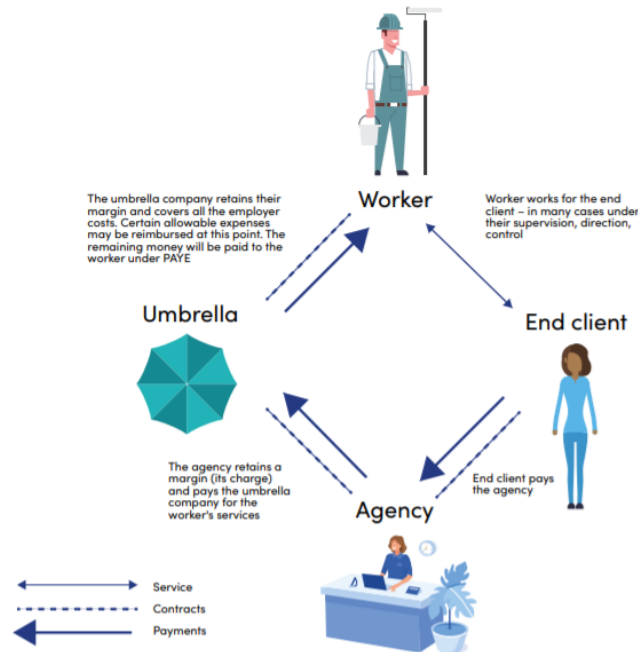
22. Umbrella companies are businesses whose sole purpose is to employ and pay people.
23. They are fundamentally a payroll service, which sometimes also directly employs the workers they pay.
24. There is no statutory definition of an umbrella company. This means the term is often used describe a wide variety of different arrangements and activities. For example, sometimes the umbrella company will be the legal employer of the agency worker. Other times the umbrella company will provide payroll services for the recruitment agency without becoming the legal employer.
25. HMRC's definition¹² of an umbrella company is: 'A UK limited company which acts as an employer to a number of individuals, meeting PAYE and other requirements, where operating legitimately. It signs contracts to provide the individual's labour to engagers, either directly or through another intermediary such as a recruitment agency.' HMRC has an interest in umbrella companies because they have been found to facilitate tax avoidance.
26. The Employment Agency Standards Inspectorate's (EAS) definition¹³ is: 'A payroll company, which might charge or deduct a fee from a work-seeker's payment that has been passed to them by an employment business to process the work-seekers' wages earned through the agency. In some cases, the work seeker will become an employee of the umbrella company.' EAS have interactions with umbrella companies because they are the enforcement body responsible for regulating the relationship between agency worker and recruitment agency. They currently don't have a legal duty to regulate umbrella companies.
27. The distinction between the two definitions illustrates the lack of consensus about which organisations would fall under the term "umbrella company". A broad definition of umbrella company is needed to make sure that the wide range of companies operating as umbrella payroll companies fall within scope of any new regulation.

¹² (March 2021). "Use of marketed tax avoidance schemes in the UK, HMRC.

¹³ (June 2021). "Employment Agency Standards Inspectorate: A brief guide for agencies", HM Govt.

How does an umbrella company operate in practice?

Illustration of typical agency worker/umbrella company supply chain



Source: "Labour Market Intermediaries", Chartered Institution of Taxation

28. There is a distinction between umbrellas operating payroll and more traditional outsourced payroll services. A recruitment agency doesn't pay an umbrella company for payroll services. In many cases the umbrella company will pay a fee, per worker, to the recruitment agency to carry out the payroll services. Our commissioned research shows this is about £15 per worker, on average.
29. This immediately raises a red flag. If the recruitment agency isn't paying for the outsourced service, it means someone else is. It is clear that this is usually the worker.

Scale of the problem

30. Umbrella companies now proliferate in all areas of the temporary economy.

Education sector and umbrella companies

There is a plethora of agencies and umbrella companies operating within the school system.

It is clear that a agencies and umbrella companies are making substantial profits in a largely unregulated sector, whilst depressing the pay of hard working and dedicated teachers.

Agencies are likely to have a preferred supplier list of umbrella companies and can often decide on which umbrella company to use based not on what is best for the agency worker, but on the best margins for the employment agency.

Umbrella companies are an additional revenue stream for employment agencies as they are able to demand upfront payments for referring an agency worker to an umbrella company. There is even some evidence that employment agencies are setting up their own umbrella companies to increase their margins through savings on payroll costs, a practice known as 'white labelling'.

Research conducted by the NASUWT¹⁴ found that almost half of supply teachers (49 per cent) reported that they had been asked to sign a contract or agreement with an umbrella company when working through a supply agency. The NASUWT engages with thousands of supply teachers and has received information that where supply teachers have raised concerns about their treatment, they have then found that they are subject to blacklisting practices by these agencies/companies. The process is that they are led to believe there is no longer any work for them. In essence, their experience is that the work just 'dries up'.

Furthermore, many teachers report that they would prefer to have the option to be paid by the recruitment agency rather than have their money processed through an umbrella company. However, agencies rarely provide teachers with a choice or alternative and often exploit the precarious nature of supply teaching so that teachers feel they have no option but to sign up.

When teachers are engaged through an umbrella company there can be a lack of transparency and misinformation about their pay rates, specifically in comparison to the rate teachers believe was advertised or agreed with the employment agency.

Problem is likely to grow with changes to IR35 rules

31. Prior to the introduction of the IR35 rules, an individual working through a limited company may have been essentially doing the same job as an employee, but they could have paid a lower amount of income tax and national insurance contributions (NICs) by taking dividends instead of a salary. The IR35 and the off-payroll rules¹⁵ were introduced to negate some of the tax benefits associated with dividends. Basically, these rules say that if a worker looks like an employee for the end client who they work for, then they should pay the same tax as an employee (however, that worker would not be entitled to the same employment rights as an "employee").
32. Broadly speaking, from April 2021, if an individual works via a limited company under the off-payroll working rules, their company invoices have to be paid after deduction of PAYE tax and NIC by the person paying the limited company. This shifts the responsibility for paying tax and NICs from the personal service company (PSC) to the end client. Government guidance states that the off-payroll working rules are unlikely to apply if you are employed by an umbrella company.¹⁶ Therefore transferring contractors

¹⁴ (2019). "Supply Teachers Annual survey of experiences", NASUWT.

¹⁵ (May 2021). "Understanding off-payroll working (IR35)", HMRC.

¹⁶ (April 2021). "April 2021 changes to off-payroll working for intermediaries and contractors", HMRC.

to umbrella companies will be a convenient way for end clients to shirk their tax and employment rights obligations.

33. In addition, the end clients have to do the employment status determination, which many may not want to do – another factor contributing to the inevitable shift of workers out of their own limited companies and into umbrella companies.
34. Most low-paid workers working through a PSC in the private sector will be within IR35 as they have little autonomy. A large movement of workers out of limited companies and into umbrella arrangements is expected.
35. By requiring existing contractors to use umbrella companies, instead of employing these workers directly and putting them on their payroll, employers will be able to avoid PAYE and employment rights obligations. The motivation to use umbrella companies is clear.

Why do recruitment agencies use umbrella companies?

36. There are two primary motivations for the use of umbrella companies:

Recruitment agencies want to outsource their PAYE and employment rights obligations to an external organisation.

37. Many employers and recruitment agencies do not want to have the fixed costs and obligations of an employer and look for a temporary, flexible workforce. Umbrella companies facilitate this by taking on responsibility for these costs and obligations, which include:
 - Paying salary, including ensuring payment of at least the national minimum wage
 - Employers' National Insurance contributions (NIC)
 - Holiday pay
 - Auto enrolment for workplace pensions
 - Statutory sick pay
 - Other statutory payments, such as statutory maternity pay
 - Operating Pay As You Earn (PAYE), including collection of student loan repayments
 - Reporting PAYE information and paying HMRC at regular intervals (Real-Time Information)
 - Issuing pay documents to workers

Recruitment agencies can receive substantial referral fees for passing workers on to an umbrella company.

38. As an agency can decide which umbrella companies they are prepared to work with, this puts them in a position of relative power, with the consequence that referral fees

are commonplace. Our research flagged up that some agencies look for anything between £5-£15 per timesheet¹⁷, to refer workers to certain umbrella companies.

39. There is also the well-known practice of umbrella companies making incentive payments to individual recruitment agents, which can be a deciding factor in terms of where the workers are referred to.
40. We understand that some agencies have a business-to-business relationship with umbrella companies and prevent individual recruitment agents from accepting these rebates directly, for example seeking instead a single financial settlement for an umbrella company to be on a Preferred Supplier List. These sums can be many thousands of pounds.¹⁸ Whatever form the payments take, it is a very powerful tool for umbrellas to gain business and agencies to potentially earn income. It could also incentivise agencies to move workers around from umbrella to umbrella purely to generate income for the agency/recruitment consultant.
41. The Loan Charge All-Party Parliamentary Group flagged this up as a primary motivation for recruitment agencies to use umbrellas.¹⁹ They found that recruitment agencies demand 'kickbacks' or incentives from umbrella companies for being added to a preferred supplier list/recommended to clients, even sometimes including fitted kitchens and holidays for recruitment agency directors. This then incentivises non-compliant providers (who because of non-compliance have higher margins) to offer large bonuses to gain access to potential clients.

What problems do umbrella companies cause for workers?

42. Workers face misleading and unfair deductions from pay. An agency worker using an umbrella company will often not receive the pay rate advertised by the agency. Umbrella companies deduct their operating costs from an agency worker's pay. Payslips are often indecipherable. Understandably this causes great anger when workers receive their payslips.
43. Breaches of holiday leave and pay entitlement are widespread, with umbrella companies preventing workers from taking their holiday.²⁰
44. Large proportions of umbrella workers are not receiving the Key Information Document that they became entitled to from April 2020.²¹ A recent survey of 3,320 contractors found that 86% of contractors had not been provided with a Key Information Document (KID).
45. The use of umbrella companies fragments the employment relationship. Workers are not sure who to speak to resolve problems and can be passed from pillar to post when trying to sort out their issues.

¹⁷ Ibid 6

¹⁸ Ibid 5, paragraph 281

¹⁹ Ibid 5

²⁰ (20 March 2021). "Homeowners speak out on gagging clauses", Money Box, BBC.

²¹ (December 2020). "IR35 ROAD AHEAD SURVEY 3,320 CONTRACTORS", IR35 Shield.

46. It's been widely reported that workers can become unwittingly embroiled in tax evasion schemes, operated by the umbrella company.²² 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. This has had tragic consequences for a number of workers.²³
47. There is no proper regulation of the sector. Labour market enforcement bodies are not regulating umbrella companies despite the government accepting a recommendation from the Taylor Review into Modern Working Practices, that enforcement of umbrella companies should be stepped up.

Do umbrella workers benefit from additional employment protections?

48. Theoretically, being a direct employee of the umbrella company should create legal entitlements to key employment protections. Workers who are employed by umbrellas should be entitled to a range of employment rights (subject to qualifying periods) including redundancy payments, unfair dismissal protections, maternity leave and pay and they should be paid between assignments if they are not working.
49. The research we commissioned suggested that these benefits were largely theoretical and didn't find any evidence of this happening in practice.
50. It should be noted that the 'extra' rights that come with employee status by working through an umbrella company, as compared to a 'worker', may not be very valuable to an itinerant worker who moves around from umbrella company to umbrella company. For example, rights to claim for unfair dismissal or a redundancy payment are only available after two years' service.

Alternative regulatory measures which have been mooted will not be effective

51. There are a number of proposals that have been put forward to regulate the umbrella industry.

Licensing

52. The TUC supports the use of licensing to ensure adherence to employment standards in many sectors of the labour market as it provides a robust, pre-emptive system of enforcement. Regular inspections and routine monitoring of standards that licensing entails helps to prevent exploitation. Licensing requires organisations operating in a particular sector to prove that they can comply with minimum employment standards. This involves providing evidence of compliance with core labour standards through initial and ongoing inspections.
53. However, we don't believe that licensing would be an adequate regulatory solution for umbrella companies for a number of reasons:

²² Ibid 5

²³ Ibid 4

- Umbrella companies are not carrying out an essential role in the labour market. The payroll function they perform could be carried out by the agency or end client who engages the worker. Because of the wide range of exploitative practices they adopt, which are harmful to workers, the most effective regulatory solution is a ban,
- A comprehensive, in depth understanding of tax law is required to understand whether an umbrella company is operating lawfully. The existing licensing regulator, the GLAA, is not required to have this knowledge to enforce licensing standards in the sectors that it licenses.
- The nature of umbrella companies – they can operate online, they can liquidate and spring up elsewhere under different guises, they can operate offshore and be difficult to track down - could make licensing very difficult. The current licensing scheme operated by the GLAA involves speaking with workers, labour providers, end clients and inspecting premises. These are all tangible things which makes enforcement easier.

Due Diligence

54. Due diligence processes have been proposed as a way of weeding out exploitative umbrella companies.²⁴ But greater due diligence in supply chains is not adequate protection for workers:

- Currently, there are no meaningful sanctions for those agencies that engage with exploitative umbrella companies, or for those who fail to carry out robust due diligence checks. Due diligence is a voluntary process, with no repercussions for non-compliance.
- It's too easy for umbrella company poor practice to slip through the net. Due diligence could be little more than tick box exercise. There is no independent regulator to verify that the information being given by the umbrella company is accurate.
- Recruitment agencies can't be expected to have a comprehensive knowledge of tax legislation, so will be unable to say with any certainty whether an umbrella company is complying with tax legislation.

Proposed regulatory measures - TUC recommendations – TUC Action plan

Outright ban on using umbrella companies

55. The TUC doesn't believe that umbrella companies are carrying out necessary function in the labour market. The use of umbrella companies appears to have nothing to do with supporting workers, and more to do with parts of the labour supply chain taking an additional cut out of payroll funds. Employment agencies should be required to pay and employ the staff they place with end clients.

²⁴ (Oct 2020). "Checklist 7A - Intermediaries checklist for umbrellas", Recruitment and Employment Confederation.

56. For these reasons we believe that a complete ban on the use of umbrellas is the only way to prevent the exploitation that umbrella workers face.
57. In May 2021, amendments were tabled to the Finance Bill by a cross-party group of MPs led by Conservative David Davis.²⁵ If passed, one of the amendments, could have stopped umbrella companies from operating at all from April 2022. There is clearly an appetite, across the political spectrum, to ban umbrella companies.

Joint and several liability in supply chains

58. Umbrella companies fragment employment relationships and extend supply chains, eroding the accountability and obligations of recruitment agencies and end clients. They are used by agencies and end clients to shirk their employment rights and tax obligations.
59. Parts of UK employment law already provide for joint and several liability arrangements. We provide an overview in our report "Shifting the Risk".²⁶ The TUC is calling for this approach to be extended, so that organisations that transfer their obligations to other parties, can still be found liable for any breaches of the core employment rights of the people who do work for them.
60. This would bring the following benefits:
 - Joint and several liability ensures that in phoenixing cases, where company directors put companies into insolvency to avoid their employment and tax obligations, workers would still have a route to enforce their rights.
 - Widening liability would ensure contractors are more diligent and careful in choosing their subcontractors.
 - Joint and several liability may also have the benefit of incentivising the creation of more secure, permanent employment, as fewer contractors take the risk of working with subcontractors that might create liabilities for them.

New trade union rights

61. In recognition of the vital role that unions perform in the workplace, the TUC believes that unions should be given new powers and responsibilities that would help them to drive up and enforce workplace terms and conditions.
62. We set out our proposals for reform in our recent report, "A Stronger Voice for Workers".²⁷ These include:
 - Unions to have access to workplaces to tell workers about the benefits of union membership and collective bargaining (following the system in place in New Zealand).

²⁵ (May 2021). "Finance Bill 2021 Report Stage - Government pressed over global minimum tax rate and umbrella companies", Chartered Institution of Taxation.

²⁶ (2018). "Shifting the Risk", TUC.

²⁷ (2019). "A stronger voice for workers - How collective bargaining can deliver a better deal at work", TUC.

- New rights to make it easier for working people to negotiate collectively with their employer, including simplifying the process that workers must follow to have their union recognised by their employer for collective bargaining and enabling unions to scale up bargaining rights in large, multi-site organisations.
- Broadening the scope of collective bargaining rights to include all pay and conditions, including pay and pensions, working time and holidays, equality issues (including maternity and paternity rights), health and safety, grievance and disciplinary processes, training and development, work organisation, including the introduction of new technologies, and the nature and level of staffing.
- The establishment of new bodies for unions and employers to negotiate across sectors, starting with hospitality and social care
- Trade unions should be actively involved in labour market inspections. There should be tripartite labour inspection audits (involving union and employer representatives as well as state officials) to help governments identify and remedy weaknesses in labour inspection.

Immediate steps whilst ban is being implemented:

63. We firmly believe that an effective ban on umbrella companies and the other measures suggested above are essential to end abuse by umbrella companies. The government should use its long-awaited employment bill to do so. Nevertheless, such changes might take some time to devise and implement and we have identified two key interim steps that could be taken that would provide additional protections for many agency workers:
64. The Conduct Regulations (the legislation which regulates the relationship between recruitment agency and agency worker) should be amended to make it clear that an agency worker must be paid the gross hourly rate advertised by recruitment agency. This would mean that the only deductions from their pay is any income tax or national insurance that they are liable for. They wouldn't, for instance, see employer NICs deducted from their wages.
65. HMRC should re focus its enforcement activity so that the promoters of tax schemes are targeted, rather than individual workers. The recent All-Party Parliamentary Loan Charge and Taxpayer Fairness Group²⁸ heard that not one promoter of disguised remuneration schemes has been prosecuted.

²⁸ (April 2021). Committee Stage of the APPG Inquiry - <https://twitter.com/loanchargeAPPG/status/1384525695221735427?s=20>