

Tackling non-compliance in the umbrella company market - consultation

Response from the Trades Union Congress

August 2023

Why the Trades Union Congress (TUC) is responding to this consultation

The TUC is the voice of Britain at work. We represent more than 5.5 million working people in 48 unions across the economy. We campaign for more and better jobs and a better working life for everyone, and we support trade unions to grow and thrive.

Our affiliated unions represent workers using umbrella arrangements across a range of sectors in the labour market, both in the private and public sector. Umbrella arrangements affect agency workers working via recruitment agencies and independent contractors carrying out work for organisations.

Unions report that union members working under these arrangements experience a multitude of problems ranging from a lack of transparency over core terms and conditions such as pay rates, to unwittingly becoming embroiled in fraudulent tax arrangements with serious financial consequences.

We welcome the opportunity to engage with this consultation and present our views on the most effective way to stamp out worker exploitation in the umbrella industry.

The TUC believes that the only effective way to prevent the exploitation of workers by umbrella companies is to prohibit recruitment agencies and employers from using them.

Why the TUC believes a ban on umbrella companies is justified and proportionate

Widespread, serious worker exploitation

1. Unions have reported that the following problems frequently arise:
 - a. 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. Other deductions can appear on a worker's payslip such as 'apprenticeship levy'. This causes both confusion and anger when a worker receives significantly less than agreed and expected.
 - b. In some cases, workers are not paid at all and when they try to resolve the problem, find themselves being passed between agency, umbrella and the organisation they are carrying out the work for. Unions have reported umbrella companies going bankrupt and failing to pay their workers. When these workers contacted their recruitment agency, they were told that the umbrella company was their employer and responsible for paying them.

- c. Payslips are often indecipherable. Umbrella company payslips are more confusing than usual payslips. This is often down to the inclusion of the 'contractor statement' as well as the actual payslip. This contractor statement starts with the contractor's overall invoiced amount and then lists the employer deductions, including the umbrella company's margin and employers' NIC, Apprenticeship Levy payments and so on. This is particularly confusing for the many workers who are unaware that they are working through umbrella arrangements or what this entails.
- d. Breaches of holiday leave and pay entitlement are widespread, with umbrella companies preventing workers from taking their holiday. Unions report that umbrella companies are also, unlawfully, giving 'rolled-up holiday pay' to their workers. Workers receiving rolled-up holiday pay receive their holiday pay as it accrues, meaning that if they do take leave, it is unpaid. This is a significant barrier to workers taking leave, which is vital to safeguard their health and wellbeing.
- e. As the Call for Evidence shows, from 6 April 2020 regulation 13A of the Conduct Regulations came into force. It requires employment businesses to provide agency workers with a Key Information Document (KID) when they register with the employment business and before it can provide them with any work-finding services. The KID should provide a range of pay-related information, including the minimum rate of pay the agency worker can expect, who should pay them, how often they are paid and if there are any agreed deductions. An account and explanation of any differences between the rate of pay given to the umbrella company by the employment business, and the sum provided to the worker after all agreed fees and deductions must be given. Large numbers of agency workers working under umbrellas do not receive the KID they have been entitled to since April 2020. Please see the box below highlighting evidence from a recent NASUWT survey.
- f. The use of umbrella companies fragments the employment relationship. Workers are not sure who to contact when trying to resolve problems and can be passed between companies when seeking to resolve their issues.
- g. 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.¹
- h. Even though the umbrella company can sometimes be the legal employer of the worker, this does not reflect the reality of the working relationship. This is evident when workers try to resolve problems and are turned away by the umbrella company. And it was apparent during the pandemic, when unions reported that umbrella companies refused

1 Savage, M. (November 2021). "Suicides linked to HMRC cash demands in 'loan charge' tax bills", *The Observer*

to furlough workers. In many cases it seems that the umbrella company's role as an employer is a sham.

- i. Many workers are compelled to use a particular umbrella company. Employment is often conditional on the worker signing up with an umbrella. Some recruitment agencies also require a worker to use a specific umbrella company that is on their preferred suppliers list because of the beneficial financial arrangements that the agency has in place, with that umbrella.
- j. BALPA, the union for UK pilots, has flagged that under some umbrella arrangements, where 'self-employed' pilots have to use umbrellas, the individual is not actually entitled to paid holiday, statutory sick pay, statutory leave/pay for working parents or statutory redundancy pay. Umbrella companies seem able to circumvent the employer/employee relationship where they choose to do so, denying umbrella workers access to the employment rights framework.
- k. The use of umbrella companies by employers seeking to avoid falling within scope of IR35 rules is resulting in pay cuts for workers. BALPA, has flagged up that some employers are forcing workers to use umbrella companies, rather than employ workers directly. They are threatening pilots with dismissal unless they sign new 'contracts'/agreements with lower pay rates to offset the higher employer NICs they have to pay via the umbrella arrangements.
- l. IR35 was extended to offshore energy in April 2021. There is an established contractor culture in oil and gas and a significant number of contractors in the offshore wind sector. UK Offshore wind farms are expected to support over 104,000 jobs by 2030 (under 33,000 today) according to employers.² These jobs must be directly employed or genuinely self-employed – growth in this area must not benefit umbrella companies which would lead to large pay penalties and a reduction in social security protections for these workers.

² Offshore Wind Industry Council (June 2023). "Offshore Wind Skills Intelligence Report". Offshore Wind Industry Council.

Impact on the Treasury – less revenue due to umbrella companies operating disguised remuneration schemes

Reports have suggested that ‘umbrella’ companies may be costing workers and the exchequer as much as £4.5bn a year, with £1bn in lost revenue from fraud including mini-umbrella companies.³

The Freelancer & Contractor Services Association (FCSA) is a leading membership body for umbrella companies. It has confirmed that the unlawful tax practices adopted by umbrellas means that “HMRC are also robbed of essential tax revenue that could be supporting essential services”.⁴

There are alternatives to umbrella companies that wouldn’t lead to the exploitation of workers.

The TUC believes that there are alternative arrangements for handling recruitment agencies’ payroll functions that would not involve the exploitation of workers.

We support the view of Unite the Union, which has many members affected by umbrella arrangements, that there is no need to use umbrella companies “in a modern economy with numerous electronic and digital payroll solutions”.

What is the scale of the problem?

There are different estimates about the numbers of workers using umbrella companies. They all suggest that a large, significant number of workers are using them.

It’s estimated that 50 per cent of agency workers work via umbrella companies.⁵ Analysis suggests there are approximately 1.4 million individuals involved in agency work.⁶

Around 325,000 freelancers are estimated to be using umbrella arrangements.⁷

HMRC estimates suggest that there has been an increase in the number of individuals working through an umbrella company from 100,000 in the tax year 2007/08 to at least 500,000 in the tax year 2020/21.⁸

3 Jolly, J. (May 2021). “Hidden cost of umbrella companies in UK ‘may top £4.5bn a year”, *The Guardian*

4 Freelancer & Contractor Services Association (July 2021). “Banning Umbrella Companies Is Not The Answer – FCSA Responds To TUC Statement”, FCSA website.

5 Low Incomes Tax Reform Group (March 2021). *Labour Market Intermediaries*, Low Incomes Tax Reform Group

6 HM Revenue & Customs (July 2021). *Tackling disguised remuneration tax avoidance*, HMRC.

7 Ibid footnote 9

8 H Treasury et al (November 2021). *Call for evidence: umbrella company market*, HM Treasury https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1037093/Umbrella_Company_CfE_Final.pdf

In 2020, the FCSA published an article suggesting the number of umbrella employees had increased to 625,000 with around 400 to 500 umbrella companies operating in the UK.

HMRC, public bodies and tax experts have also indicated that there has been a shift in how hiring organisations approach the contracting and procurement of services following the IR35 reforms. This includes the increased use of umbrella companies, acting as intermediaries for multiple contractors. HMRC has observed an increase in the number of people employed by umbrella companies.⁹

As employers seek to comply with IR35 or avoid their employment/payroll obligations, it is likely the use of umbrella companies will increase.

Why are umbrellas used?

There are two principal reasons why umbrella arrangements are used by recruitment agencies and employers.

Firstly, they reduce the administration associated with employing workers. The agency or employer no longer has to operate a payroll and they can escape their responsibilities, such as obligations under the employment rights framework. The TUC believes that organisations and recruitment agencies should take responsibility for paying their staff and ensuring their workers' employment rights are upheld.

Secondly, recruitment agencies are given substantial financial incentives to use umbrella companies. This is where the use of umbrella companies significantly differs from other outsourced payroll services. Instead of recruitment agencies paying a fee for another organisation to operate their payroll, the agency is actually given a referral fee (or other form of financial incentive) for every worker passed to the umbrella company.

This was confirmed in a report by the Loan Charge All-Party Parliamentary Group:

Recruitment agencies demanding '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.¹⁰

Often umbrella companies are used so that recruitment agencies and their directors can make more money at the expense of the worker. The worker pays for this, when a proportion of their salary is deducted to pay an operating fee to the umbrella company.

9 National Audit Office (February 2021). *Investigation into the implementation of IR35 tax reforms*, National Audit Office

10 Loan Charge All-Party Parliamentary Group (April 2021). "Inquiry on 'How Contracting Should Work'", Loan Charge All-Party Parliamentary Group

TUC response to the specific proposals set out in the consultation document.

Questions 1-3. Defining umbrella companies.

The TUC does not believe that either of the options are broad enough in scope to cover all workers who use umbrella arrangements. As we've flagged above, it is estimated that 325,000 freelancers/independent contractors use umbrella arrangements. These workers seem to be excluded from the two proposed definitions, as the proposed definitions only cover workers who use umbrellas via an employment business. Many independent contractors using umbrella arrangements would not use an employment business.

The TUC believes that the proposed definitions have been developed with the pre-determined view that EAS would regulate umbrella companies, and therefore only umbrella workers who are engaged by employment businesses are covered. Any regulatory definition should take into account the full range of workers who are affected by umbrella arrangements and make sure the definition is broad enough in scope to cover these workers.

Questions 4-5. Umbrella company standards.

Given the wide-ranging, egregious exploitation faced by umbrella workers, the TUC believes that the most appropriate and effective way to stamp out the exploitation caused by umbrella companies is to prohibit recruitment agencies and employers from using them.

However, if the government is committed to introducing further regulation that enables umbrellas to continue to operate, then we suggest they consider more effective regulatory solutions:

- Strengthen the conduct regulations to make sure agency workers are always paid the advertised rate.
- Force agencies to pay the operating costs of the umbrella company, rather than the worker paying the fee. If agencies want to use umbrellas then they should pay for the service. Workers should not be left in the absurd position where they must pay a fee to receive their wages.
- Significantly increase the resources for EAS, enabling them to recruit enough inspectors to meet ILO benchmarks.
- Ensure that a worker is not forced to use one particular umbrella company (many agencies have preferred supplier lists) and can always opt for a direct PAYE option with the agency/organisation that they are doing work for.
- Make it unlawful for agencies to receive financial incentives or 'kickbacks' from umbrella companies, via timesheet commissions, introductions, or otherwise.

- Extend the existing Naming and Shaming scheme so that umbrella companies that flout employment rights are within scope. This would also assist agencies and end hirers carry out due diligence.
- The TUC advocates for strict joint and several liability in UK supply chains. This would enable a worker who was not paid holiday pay, the correct NMW rate or sick pay, to bring a claim against any contractor above them in the supply chain. Any contractor in the supply chain would be strictly liable to provide compensation to the worker.

There should be further consultation, including with trade unions that represent umbrella workers, to determine the regulatory standards that should be implemented to stamp out worker exploitation.

Questions 6-8. Enforcement of umbrella company standards.

The TUC believes that given the expertise of EAS staff and their knowledge of the recruitment sector it is the enforcement body best placed to regulate umbrella companies.

However, the EAS does not currently have enough resources or experience of the freelancer/contractor industry to effectively regulate umbrella companies. Therefore, its remit and resources would have to be expanded significantly.

The EAS does not have the resources to tackle exploitation by umbrella companies. The TUC believes that EAS is under resourced to carry out its existing regulatory duties in the recruitment sector. There are approximately 40,000 employment agencies operating in the UK.¹¹ Yet the EAS is expected to regulate the agency sector with just 19 inspectors.¹² Neither is the wider labour market enforcement system equipped to effectively regulate umbrella companies. The International Labour Organisation (ILO) benchmark for inspectors, which it recommends all countries meet, is one labour market inspector per 10,000 workers.¹³ Unique TUC analysis¹⁴ of labour market enforcement statistics shows that the UK would need an additional 1,797 labour market inspectors to meet the ILO benchmark.

The TUC believes that the EAS should be given enhanced powers to enable it to regulate the umbrella sector effectively. The EAS should be able to issue civil penalties (fines) to umbrella companies that flout regulations and existing employment law. This would create a deterrent effect for other umbrella companies and strengthen the existing enforcement approach of the EAS.

11 Chartered Institution of Taxation (March 2021). *Labour Market Intermediaries*, Chartered Institution of Taxation

12 Department for Business, Energy and Industrial Strategy answer in response to written parliamentary question (UIN 122725)

13 International Labour Organisation (November 2006). "Strategies and practice for labour inspection", Committee on Employment and Social Policy, International Labour Organisation

14 Office for National Statistics, A01 and EMP17 data tables

It's also vital that the EAS is resourced to be able to undertake both reactive and proactive investigations. Both approaches have their merits and are not mutually exclusive, if an inspectorate is resourced sufficiently.

In response to paragraph 3.48 the TUC firmly believes that unions should be able to bring claims on behalf of umbrella workers who are exploited and that the EAS should not just accept complaints from individuals. Trade union reps and officials are a trusted source of advice in the workplace and workers often rely on union reps and officials for advice and support when resolving workplace disputes.

Question 9-20. Option 1: Mandating due diligence.

The TUC believes that a legal requirement, on both agencies and the end hirer, to carry out a robust due diligence process could reduce both employment rights and tax non-compliance in their supply chains. Effective due diligence processes would require organisations to undertake checks which would help them uncover unlawful and exploitative practices from labour market intermediaries trying to operate in their supply chains.

A legal requirement to follow a robust due diligence process and carry out regular risk assessments, of any likely breach of tax and employment rights legislation in their supply chains, would probably reduce the use of umbrella companies. Unlike agencies, end hirers have little financial incentive to use umbrellas but could shoulder significant responsibility.

However, the TUC is concerned that questions 9-20 predominantly focus on tackling *tax* non-compliance via a new due diligence requirement. Whilst it is important that HMRC can effectively recoup the tax it is owed, it is also important that end hirers and recruitment agencies carry out due diligence to ensure that labour market intermediaries in their supply chains comply with relevant employment standards and employment rights obligations.

The consultation focuses on tax non-compliance which is evident by the very specific tax proposals put forward in the consultation document. But any new due diligence requirement must extend to compliance with employment rights in supply chains.

The TUC supports mandatory due diligence processes and is part of a campaign group calling for robust new mandatory human and labour rights and environmental due diligence legislation in the UK. We've set out the core components of an effective due diligence process:

- Premised on core legal duties to respect and prevent adverse human and labour rights and environmental impacts.
- Imposes substantive due diligence obligations on organisations.
- Enables legislation/regulations to be robustly enforced via a tripartite regime of civil claims, regulatory oversight and criminal sanctions in order to provide an accessible and effective deterrent.

- Enables trade unions to play a vital role within the due diligence process and use of accountability mechanisms.
- Allows for joint and several liability (more than one organisation being legally accountable for the harm) on the establishment of breach in civil claims.

In the context of umbrella companies, the TUC believes it is important for any due diligence procedure to take into consideration the following key factors:

- The duty to carry out due diligence must extend to both employment businesses and the end hirer organisation.
- Failure to carry out due diligence must result in a financial penalty. Financial penalties must be large enough to deter other hirers and employment businesses from engaging exploitative umbrella companies.
- Due diligence process must be robust and comprehensive. Currently, many recruitment agencies simply check whether an umbrella company is accredited with a voluntary accreditation body such as the FCSA. This is inadequate as these are voluntary bodies that set their own standards and it is unclear how effective their enforcement methods are when dealing with umbrella companies that breach their standards.¹⁵ Umbrella companies that are accredited with voluntary bodies have allegedly committed breaches of employment rights.¹⁶ This demonstrates that a cursory check with a voluntary accreditation body would not reveal unlawful and exploitative practices.
- The TUC believes that if the government chooses to proceed with this regulatory approach, then the government should consult further about what constitutes an effective due diligence procedure with all relevant stakeholders, including trade unions.

Question 21-33. Option 2: Transfer of tax debt that cannot be collected from an umbrella company to another party in the supply chain.

The TUC supports option 2. As the consultation points out, when HMRC cannot recoup a tax liability from the umbrella company it will pursue the worker for the debt. The TUC welcomes any provision that will enable HMRC to pursue other actors in the supply chain, other than the worker.

Umbrella working arrangements are extremely complicated and many workers and agencies are not aware of the full tax and employment rights implications of working under these arrangements. Also, many workers will accept agency assignments at extremely short notice, so it is not practical for workers to check or fully understand the potential consequences of working with an umbrella. This is one of the reasons why we

¹⁵ Kermode, J, (16 May 2023). "FCSA Decision In Umbrella 'Skimming' Case". Iwork.

¹⁶ (22 March 2021). "BBC Moneybox exposes FCSA umbrella accused of withholding £000's from contractors". Contractor Calculator.

believe an outright ban on umbrellas is necessary. Failing that, ensuring that the tax debt can be transferred to another organisation in the supply chain is a positive step.

The TUC believes that this option would remove the incentive that organisations currently have to effectively outsource their payroll responsibilities to umbrella companies, by introducing a potential liability in the event that the umbrella company does not comply with its obligations.

The TUC believes that HMRC should be able to transfer and recover a tax debt from both the employment business and end hirer in the supply chain.

The TUC believes that regardless of whether an employment business or end hirer has exercised due diligence in deciding to contract with a particular umbrella company, they should still be liable for the transfer of a tax debt. If that organisation had carried out effective due diligence then arguably it would not have contracted with an umbrella company that chose not to pay their tax liability.

The TUC believes that both options 1 and 2 could operate alongside each other.

Question 34-41. Option 3: Deeming the employment business which supplies the worker to the end client to be the employer for tax purposes where the worker is employed by an umbrella company, moving the responsibility to operate PAYE.

The TUC does not support this option.

We do not believe there should be a deemed employer with responsibility for ensuring the correct tax and national insurance are paid, unless they also have responsibility for the employment rights of the worker as well.

The effect on the worker would be to have one employer for pay purposes and one employer for employment rights purposes. This is an unreasonable position to place a worker in.

Umbrella arrangements are already complicated enough with many umbrella companies and agencies not understanding that the umbrella company will be the legal employer of the worker. Workers are passed between umbrella and agency with neither taking responsibility for their employment rights obligations. This proposal has the potential to exacerbate this situation.

Use existing powers to tackle umbrellas now, rather than wait for further legislation

There are steps that the EAS could take immediately, rather than waiting for new regulation:

- The EAS should carry out pro-active enforcement of Regulation 5 of the Conduct Regulations that states that an agency “may not make your work-finding services conditional upon the work-seeker using other goods or services provided by you or someone else”. Yet, it is common practice for agency workers to be offered

assignments that are conditional upon them signing up with an umbrella company, which then deducts its operating fee from the worker's wages.

- The EAS should carry out a proactive investigation into agency non-compliance with the Key Information Document.