Loan Charge Action Group

Submission to the Treasury Consultation on Umbrella Companies

Introduction

This is a submission from the Loan Charge Action Group to the 'Tackling non-compliance in the umbrella company market' open consultation conducted by Her Majesty's Treasury.

We are submitting a general consultation paper, rather than merely providing answers to the questions posed, as we feel that (a) the questions are too specific and (b) that there are more fundamental issues that the Government must address, which we want to outline here. We are also concerned that the nature of the consultation suggests that the Government may not be intending (at this stage) to take the action that is really needed to stamp out the chronic malpractice in the umbrella sector, which must be the aim of any forthcoming legislation.

Our members and umbrella companies

This submission is made on behalf of our members who are currently, or were previously, contractors/freelance workers or small company directors. They all now face, or have faced, HMRC action which is related to remuneration arrangements that they had been assured were legal, legitimate and tax *compliant*. This action has been life-ruining for many and a key reason they have ended up in this situation is due to umbrella companies.

Our members include many workers who have used umbrella companies, with these companies themselves recommending that they used payment arrangements which are now subject to the Loan Charge. The reality is that tens of thousands of people have faced HMRC action as a result of the advice given by those umbrella companies.

Responses to the consultation

We note it has been publicised that there has been a low response rate to this consultation (which it must be remembered is a follow-up to the wider consultation last year). This is for two obvious reasons.

Firstly, the design of this consultation is a lengthy set of very specific questions, many of which individual contractors will not necessarily have a view on; what they *want* is action to stop them being mis-sold and exploited.

Secondly, the reason for the previous poor response is no doubt because the Treasury has shown again and again that its 'consultations' on these kinds of issues are no more than lip-service. Past experience informs us that they give the entirely false impression that the Treasury seeks outside views and experience. The reality is that they have already made up their mind (in conjunction with HMRC) and will implement what they have already decided, regardless of any legitimate concerns and expert testimonies strongly advising against. This applied to both the 'consultations' over the Loan Charge and IR35 changes.

In both cases, the Treasury was presented with significant amounts of compelling evidence as to why the policies were utterly flawed, and would have a devastating effect if implemented. They chose to ignore all advice and concerns and bullishly forged ahead anyway, and are now facing exactly the negative outcomes that had been predicted. It is hardly surprising, therefore, that many people, including individuals affected so severely by the retrospective Loan Charge and by the poorly thought out IR35 changes - together with sector professionals who are trying to deal with the fallout from both - see little point in spending time contributing to any largely futile Treasury consultation.

We also share the view (which has been widely expressed by many other parties), that it is beyond frustrating to have taken 18 months to get to this point. With the General Election coming next year, we remain concerned that this Government will run out of time to deliver much needed reform and for the right measures to be put in place to amend the damage that it has caused. Legislation must be brought forward before then and make it onto the statute book in *this* Parliament. Of equal importance is that it must be the *right* legislation, to stamp out the mis-operation and mis-selling of tax avoidance schemes and to compassionately deal with the serious problems that are facing contractors and other flexible workers, all of whom are being denied their rights and the benefits to which they are entitled.

What should the Government be seeking to do

We want to see three *vitally* important things achieved from this consultation by the Government/HM Treasury:

1. To completely stop (and to properly outlaw) umbrella companies putting workers into or recommending arrangements that Government/HMRC then, years later, retrospectively deem to be tax avoidance schemes by making the umbrella companies themselves liable for any subsequent failings of the arrangements and to not pass this on to the unsuspecting worker.

2. To stop all unlawful or non-legitimate deductions, including the withholding of holiday pay, 'skimming' of pay via bogus 'deductions' and Employers National Insurance payments.

3. To ensure that those deemed as and treated as *employees* have rights and benefits as *employees* (and to stop and outlaw zero-rights employment).

We are not convinced - from the wording of the consultation, the questions being asked and the assumptions being made by the Government - that the three key elements above (which would impact the *workers* in a positive way) will be delivered.

Our concerns about the consultation

Our biggest concern about the consultation (that is clear from reading the document content and the potential measures mentioned therein) is that the Treasury does not understand the role that an umbrella company plays within the supply chain.

In many cases, an umbrella company is used simply because the engaging agency does not want to perform a payroll function, so it insists on the involvement of an umbrella company. This unnecessarily complicates the supply chain and reduces transparency, which is precisely what creates the environment for the well-documented malpractice on the part of some – and far too many -umbrella companies.

The consultation appears to assume that umbrella companies act as the workers employer. However, in most instances, the umbrella company simply processes funds. The engagement with the end user

is made under a contract with an employment agency obliging the contractor to work for the end user. The control over the contractor's activities is exercised by the end user who tells him/her when to work, what work to do and gives him/her a specific function. Often the contractor will work alongside permanent employees performing identical functions. Umbrella companies do not practically have any supervision, direction, or control over the worker at all.

In this case of Blakely v On-Site Recruitment UKEAT/0134/17/DA, Justice Choudhury suggested that one must go back to the start of the relationship, quite possibly before the umbrella company had any part in the arrangements. He said it was likely the umbrella company was acting as the agent for the agency, which would be the contractor's principal employer and whilst you may have an express contract with an umbrella company, which purports to be an employment contract, if they were your true employers, they have a statutory obligation to pay Employer's NICs and to not deduct these costs from you. This only goes to prove that in very many cases (unless they perform a genuine employer role, with proper employment benefits), umbrella companies are <u>not</u> real employers, but sham employers and more akin to a payroll bureau.

We are also concerned that the consultation is flawed and partial, because it fails to recognise the impact of the flawed 'IR35 legislation' and how this is being implemented, which is a major factor in the use and proliferation of umbrella companies. It is notable that HMRC themselves have not engaged <u>any</u> contractors outside IR35 in the past year, as has been revealed in its recently published Annual Report and Annual Accounts. This means that the vast majority of these workers had to work through umbrella companies, with the sector being unregulated and with HMRC themselves warning people on their website - "*If you're a contractor, you may be employed through an 'umbrella company'. If you're not sure, it's best to check as some umbrella companies try to break the tax rules*". It has also been noted that this is a far more expensive way of engaging contract workers than deeming them outside of IR35 and allowing them to provide their services via a personal service company. HMRC is therefore wasting taxpayers' money - and at the very same time fuelling demand for unscrupulous umbrella companies.

This is (alas) so typical of the mess created by bad legislation and the double standards on display from HMRC. For the consultation to ignore the impact of IR35 legislation (and HMRC's own questionable decision-making) means it is <u>not</u> the broad consultation that is badly needed – which is to stop abuse and to clarify the difference between employment and self-employment, and to properly verify the working status of 'contractors'. These questions *must* be resolved if the Government is serious about tackling the unnecessarily complex supply chain for flexible workers, with this complexity being a key factor in the promotion of tax avoidance schemes and umbrella company malpractice.

HMRC's failure to implement the agency provisions

Umbrella companies have played a key role in the Loan Charge Scandal. Umbrella company bosses and their owners have made a very considerable profit from recommending and facilitating what HMRC calls 'disguised remuneration' schemes, whilst those who were advised and, in some cases, obligated to use the umbrella and related schemes face absolute ruin.

The approach of HMRC and the Government has been that contractors are employees of the umbrella company, and are seconded to the end user even though the umbrella company neither has, nor exercises, any supervision, direction, or control. When it comes to schemes subject to the Loan Charge, this approach suits umbrella companies who have been involved in loan schemes very well, since if the loan is not treated as straightforward earnings, the loans, being from an employer, are not caught by the disguised remuneration legislation.

HMRC seem happy to accept that contractors are employees of the umbrella company. It saves them the embarrassment of having to explain why they have not used the agency provisions in ss.44ff ITEPA.

If the worker is an employee, then the question is - who is the real employer? One possibility is that he is an employee of the end user or client who (i) has supervision and control and (ii) pays the income to the employment agency at the direction of the worker. If that is the correct analysis, the end user is the employer and should have deducted PAYE etc.

A second possibility is that the worker is an employee of the employment agency seconded to the end user - in which case (quite apart from s.44) the agency should have operated PAYE and NIC. Agency contracts will vary but generally an agency will not exercise supervision and control.

Then there is the umbrella company. It will generally not exercise *any* supervision or control and will simply operate as a payment processor. However, HMRC usually regard the umbrella company as the employer and umbrella companies making loans will not disagree (in order to escape the disguised remuneration legislation). If it *is* the employer, it will pay a salary which is employment income and (typically) make loans which are not taxed but which HMRC contend are employment income. Of course, only part of what is received by the worker from the end client is received by the worker. However, it could be argued legally that, on the analogy of the Rangers case, he has received what the end user has paid but given it to the umbrella company. In which case s.44 would apply either to that part of the total sum taken by the umbrella company or the entirety of the payment from the end user. The analysis would be that the worker has chosen to become an employee of the umbrella company instead of the end user. In the umbrella company's hands, the payments do not constitute employment income.

The Government and HMRC's assumption (and frequently misplaced assertion) that umbrella companies are the employers of workers has therefore been a significant problem underlying the whole Loan Charge Scandal, as has the mess created by HMRC's failure to act at the time (and then pushing through the retrospective Loan Charge legislation in order to absolve them of their own multiple failings).

The Government must therefore not merely *regulate* umbrella companies on the premise of this false assumption, it must properly define *who* is the legal employer of any flexible worker - as failing to do so will simply perpetuate the chaos and further enable the convoluted and opaque supply chain to take advantage of the uncertainties which remain in place.

The only umbrella companies which should be allowed to operate are those *genuine* umbrella companies that employ contractors through successive assignments, and provide services and benefits by fulfilling the functions of an employer, such as offering maternity and sick pay, being involved in the supervision of the worker (including their performance assessment) and any work-related disciplinary matters. Such companies, on condition of being UK resident, could commit to operate PAYE. This would retain the flexible workforce, but - at the same time - would deliver long-overdue rights to these workers and make it easier for HMRC to collect tax at source.

Other workers should be permitted to continue to operate via personal service companies where that is the appropriate model. This also then involves the Government *tackling*, rather than ducking, a proper definition of employment and self-employment and outlawing 'zero rights employment'- which has become an unacceptable and unedifying consequence of the roll-out of the flawed IR35 off-payroll rules.

Conclusion

We remain far from convinced that this Government - which is responsible for the Loan Charge Scandal and the flawed and damaging IR35 off-payroll rules - is serious about properly cleaning up the supply chain for flexible workers, despite that skilled workforce being crucial to so many UK businesses, as well as councils, Government departments and, ironically, HMRC itself.

There is a real and imminent danger of the current consultation entirely missing the point – as well as missing this perfect opportunity to amend past mistakes. This seems inevitable if, as with previous such consultations, submissions are ignored and the Government proceeds with whatever it (or HMRC) has already decided to do, regardless of the reality and the *actual* impact of the measures.

We are also concerned that if the Treasury listens at all, it will only listen to the voice of the large umbrella companies, who themselves purport to support change but (in reality) merely wish to continue to operate and to profit from offering payroll services to flexible workers without taking proper responsibility as genuine employers.

We urge the Government to *learn* from the disastrous Loan Charge Scandal, that has cost (and will undoubtedly continue to cost) lives as well as becoming a huge administrative headache for HMRC, adding even greater burden to the entirely predictable negative outcomes of the off-payroll rules. Rather than tinkering with umbrella companies alone, it is now time for this Government to do what is really needed - which is to *clearly* lay out the difference between employment and self-employment and to fully ensure that only the *genuinely* self-employed do not receive employment benefits and rights – whilst making *certain* that all other workers do.

Loan Charge Action Group
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