ICAEW
REPRESENTATION 81/23

TACKLING NON-COMPLIANCE IN THE UMBRELLA COMPANY MARKET

Issued 29 August 2023

ICAEW welcomes the opportunity to comment on the Tackling non-compliance in the umbrella company market consultation published by HM Treasury, HM Revenue & Customs and Department for Business & Trade on 6 June 2023, a copy of which is available from this link.

For questions on this response please contact us at representations@icaew.com quoting ICAEW REP 81/23.

EXECUTIVE SUMMARY

Organised crime groups (OCGs) are exploiting the UK tax system and employees. OCGs can flourish and undercut complaint operators because of ineffectual policy and inadequate enforcement by the government of employee rights, tax rules and company law.

The off payroll working problem could be permanently resolved if the total amount of tax and national insurance contributions (NIC) payable by individuals and the engagers of workers was the same or similar across all sources of income and did not vary materially depending on employment status or type of engagement.

The fundamental difficulties underlying the taxation of work need to be properly addressed by informed debate about how work should be taxed and the extent to which the tax system should distinguish between those who the tax system currently treats as employees and as self-employed.

In the meantime, the options in the consultation document for regulating umbrella companies and tackling tax non-compliance in the contingent labour market and of the VAT flat rate scheme and employment allowance are not mutually exclusive and the government could introduce a combination – but they need to be underpinned by primary legislation containing appropriate safeguards, be firmly and fairly enforced by HMRC, and be accompanied by clear guidance.

It needs to be easier for employees to enforce their employment rights, and there should be a single employment rights enforcement body as previously proposed by government.

Companies House (CH) and HMRC need to work together and take action against individuals with significant connections to non-compliant companies. The records at and powers of CH need to be substantially improved.

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
icaew.com

WHO WE ARE

This response of 29 August 2023 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 166,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

KEY POINTS

1. There are organised crime groups (OCG) operating in the umbrella company (UC) labour market who are exploiting both the UK tax system and employees. OCGs are able to flourish because of poorly thought-out tax policy and ineffectual enforcement of both the tax rules and employee rights.
2. We repeat the key points of our evidence ICAEW REP 17/22 submitted on 16 February 2022 in response to HMRC's previous call for evidence on the umbrella company market. Some of these repeat our recommendations made elsewhere, for example in our evidence ICAEW REP 30/17 submitted on 6 March 2017 to the Matthew Taylor review of modern employment practices:

    > "1. The off-payroll problem could be permanently resolved if the total amount of tax and NIC payable by individuals and the engagers of workers was the same or similar across all sources of income and did not vary materially depending on employment status or type of engagement.
    >
    > "2. This could be achieved by replacing NIC on employment income with a hirers' levy in respect of engagements with employees and the self-employed.
    >
    > "3. The fundamental difficulties underlying the taxation of work need to be properly addressed by informed debate about how work should be taxed and the extent to which the tax system should distinguish between those who the tax system currently treats as employees and as self-employed.

> "4. Compliance would also be enhanced if the taxation of work and the off-payroll working regime complied with our *Ten Tenets for a Better Tax System* by which we benchmark the tax system and changes to it (summarised in Appendix 1), in particular, it needs to be simple (Tenet 2), certain (Tenet 3) and the tax/NIC easy to collect and calculate (Tenet 4).
>
> "5. Non-compliant umbrella companies (UCs) compete unfairly with compliant UCs by undercutting their fees. HMRC needs to consider ways to encourage engagers and workers to use the compliant UCs, for example by publishing a list of UCs that it considers compliant.
>
> "6. Companies House (CH) and HMRC should work together to monitor directors and shareholders, for example to check whether tax debts, especially PAYE debts from companies with common directors and or shareholders, are correct and being paid on time, and take preventative measures against individuals who are or have been directors of or significant shareholders in companies with poor compliance records."

3. The options in the consultation document for regulating UCs and tackling tax non-compliance in the contingent labour market and of the VAT flat rate scheme and employment allowance are not mutually exclusive and the government could introduce a combination – but they need to be underpinned by primary legislation containing appropriate safeguards, be firmly but fairly enforced by HMRC and be accompanied by clear guidance.
4. Government also needs to make it easier for employees to enforce their employment rights. We agree with previously made government proposals that there needs to be a single employment rights enforcement body. Such a body should incorporate an employee whistleblowing / reporting and complaints facility to help employees assert their employment rights.
5. HMRC needs to check VAT flat rate scheme (FRS) applications and employment allowance (EA) claims, including cross-checking to data held by CH – whose records need to be substantially improved and enhanced so common directorships and/or shareholdings can be identified in real time, together with bank account details, to prevent connected mini-umbrella companies (MUCs) from inappropriately using the FRS or claiming EA.

GENERAL COMMENTS

Overview

6. A long-term solution is needed. As we said in our above mentioned evidence ICAEW REP 17/22 submitted on 16 February 2022 in response to HMRC's previous call for evidence on the umbrella company market:

> "7. The fundamental difficulties underlying the taxation of work remain. The off-payroll problem will only be permanently resolved if the advantages of tax and NIC arbitrage caused by the cost of employer NIC are removed.
>
> "8. This could be achieved if the total amount of tax and NIC payable by individuals and the engagers of workers was the same or similar across all sources of income and did not vary materially depending on employment status or type of engagement (Editorial note: as in the USA).
>
> "9. Compliance would also be enhanced if the taxation of work and the off payroll working regime complied with our *Ten Tenets for a Better Tax System* by which we benchmark the tax system and changes to it, summarised in the Appendix; in particular, it needs to be simple (Tenet 2), certain (Tenet 3) and the tax/NIC easy to collect and calculate (Tenet 4).

> "10. Ultimately, these problems can only be properly addressed by an informed debate about how work should be taxed and the extent to which the tax system should distinguish between those who the tax system currently treats as employees and as self-employed.".

Employment rights non-compliance

7. All employers should comply with employment law. However, there is no easy remedy for employees whose employers are wilfully not complying with employment law, by for example not providing paid holidays or making the employee bear the cost of employer NIC. In the words of a Citizens Advice Bureau (CAB) August 2019 briefing: "The current enforcement system is complicated, confusing and often relies on workers pursuing their employer themselves through the tribunal system.".
8. Current best advice is that employees should always try to resolve a problem at work by first speaking with their employer. If it is not possible to deal with the issue in the workplace, the employee can try to enforce their rights by bringing a claim in the Employment Tribunal (ET) (there is a three-month time limit for bringing a claim in the ET). As a prerequisite of an appeal to the ET, employees must in most cases obtain an early conciliation certificate from the Advisory, Conciliation and Arbitration Service (ACAS). Most employees will need to take advice on how to enforce their rights. This can be expensive. CAB has excellent guidance online (as does ACAS) but its offices are open only on weekdays which for many employees effectively renders tailored advice inaccessible.
9. We believe that instead of trying to introduce new definitions to cover UCs, which rogue UCs are likely to circumvent, the government should make it easier for all employees to enforce their employment rights and, as previously proposed by government, there should be a single enforcement body that covers all employment rights law. Ideally this would incorporate an employee whistleblowing/reporting and complaints facility so the enforcement body can target resources towards non-compliant employers. This would not replace the need for employees in the first instance to try to sort out grievances with their employer where possible but the enforcement body should help employees navigate the subsequent stages that are too complex for the average employee.

Tax non-compliance

10. We consider that the options are not mutually exclusive but to be effective and fair all would need diligent enforcement by a joined-up government and safeguards including rights of appeal.
11. Making businesses undertake due diligence (option 1) will be effective only if it is clear what businesses must do and is supported by enforcement and effective sanctions for non-compliance.
12. However, we question the extent to which end clients will be able to undertake meaningful due diligence on other organisations in the labour supply chain, including UCs used by the employment businesses, if they have no direct business relationship. End clients would need the cooperation of the party being checked, which could be thwarted by an uncooperative party, or appropriate legal powers unless they are connected, (eg, in the same group of companies as the organisation undertaking the due diligence). Large end clients are more able to dictate to their chosen employment agencies which UCs are acceptable, but most end clients have to accept what their employment agencies provide as they are in a weaker bargaining position.
13. Limited due diligence could be undertaken by checking public registers like CH but these do not always provide the required detail. The data at CH needs to be considerably improved so

connected companies and individuals can be identified. CH should be given powers to carry out checks. Individuals who have a history of non-compliance should be disqualified from being directors and shareholders, subject to appropriate safeguards.

14. It will be difficult for government to monitor whether organisations have undertaken appropriate due diligence unless real time records can be collected of online checks made (eg, of CH records).

15. Option 2 – transfer of, and, indeed, personal liability by directors and shareholders of UCs for tax debts unpaid by UCs would act as a deterrent. Again, there would need to be appropriate safeguards, for example, a defence that they had taken reasonable care. Guidance explaining "reasonable care" would be needed.

16. As to option 3, given that the object of the off-payroll working rules is to ensure that the end client effectively bears the PAYE costs of hiring the worker, it seems odd at first glance to deem the employment business that supplies the worker to the end client to be the employer for tax purposes. However, the business model for the end client is to be able to let go workers when they are no longer required without being responsible for complying with employment rights, which are in effect offloaded onto a UC by the employment business with whom the end client contracts. This, together with the fact that the employment business may also have a business relationship with the worker, suggests that it is probably appropriate for the employment business to be the deemed employer.

17. We would note that the corporate criminal offence (CCO) legislation means that if an "associated person" of a business criminally facilitates tax evasion, and the business is unable to demonstrate that it had reasonable procedures in place to prevent such facilitation, the business is guilty of a criminal offence. We suggest that before introducing further legislation, consideration is given to using these existing provisions.

18. We would also draw your attention to the use of an employer of record (EOR). An EOR acts as a legal employer of employees who are performing duties in one jurisdiction for another business entity based in a different jurisdiction. An EOR will typically complete payroll compliance obligations in the country in which the employee is performing duties. They will also sometimes provide other services, such as visa and relocation assistance.

19. An EOR operates by having a network of entities in several countries. The employee will sign a local employment contract with the local EOR establishment. This has several implications both from a tax and employment law perspective. These include:

    - the creation/avoidance of creation of a permanent establishment (PE) in the country in which the employee is locally contracted;
    - treaty implications – complications – for relief and treaty residence for the individual,
    - potential implications for diverted profits tax;
    - social security costs that cannot be mitigated via a bilateral agreement and payment into the 'wrong' social system; and
    - exposure to general anti-avoidance rules.

20. There is a potential loss of tax revenue. How does HMRC envisage tackling the use of EORs? Should they be included in the definition of UCs? EORs are also known as professional employment organisations (PEOs). HMRC's reply to question 21 of the 5 March 2020 Joint Forum for Expatriate Tax & NIC Q&A log regarding PEOs currently states: "PEOs are not currently within our area of responsibility but we will look into it and provide a response where possible". Is HMRC currently looking at the use of such entities?

Targeted options

21. Effective enforcement by HMRC and cross checks to CH data – whose records need substantially to be improved and enhanced so common directorships and/ or shareholdings can be identified in real time – would prevent connected MUCs from using the VAT FRS or claiming employment allowance (EA), as would cross checking bank account details to see whether other business use the same account.

ANSWERS TO SPECIFIC QUESTIONS

CHAPTER 3: REGULATING UMBRELLA COMPANIES FOR EMPLOYMENT RIGHTS

Ch 3 – defining umbrella companies

Question 1: Which of the options would be the most effective way to define umbrella companies to ensure only they are brought in scope now and ensure future regulations/standards can be targeted to the right business in the supply chain? Please explain your answer.

22. Please see answer to Q3.

Question 2: Which of the definitions would be the most future proof? Please explain your answer.

23. The definition at 3.26 does not appear to be correct:

> "Condition 1 – there should be two separate businesses (an employment business and end client) involved in supplying the worker in addition to the umbrella company".

24. The end client is not involved in supplying the worker. It receives the services of the worker.

Question 3: Are there any unintended consequences of either option and/or are there alternative ways of defining umbrella companies the government should consider? Please explain your answer.

25. Paragraph 3.21 first sentence states that:

> "…only one person or business would be permitted in the supply chain between the employment business and the individual to be supplied to do the work.".

26. We do not believe that this is realistic as supply chains may already be in place. Also, UK law has a territorial limitation so the entities may just be set up offshore.

27. Paragraph 3.25 second sentence states that:

> "First, the umbrella company would have a direct contractual relationship with the individual who is supplied to carry out the work and a separate supply agreement with the employment business.".

28. Are we correct in believing that if the contract is not directly with the individual but with the individual's personal service company, that would not be considered a direct contract, but that is not viewed as an issue because the current off payroll working legislation would cover the situation?

29. Condition 2 in paragraph 3.26 states that:

> "…the putative umbrella company has a direct contractual relationship with the individual to be supplied to an end-hirer that makes the umbrella company responsible for paying the individual the agreed rate.".

30. The difficulty here is that the contract with the worker has to have the agreed rate specified.

31. A way around this is for the contract between the individual and the UC not to mention any agreed rate but the rate to be specified in a contract between the employment company and

the individual. The contract between the employment company and the UC would then specify the rates.

32. Alternatively, the contract could be rewritten so that the contract between the end client and the employment company could specify the rate to be paid to the worker and separately the "finders fee" for providing the worker.

33. This legislation is aimed at cases where there is a connection between the employment business and the UC. Section 24, Income Tax (Earnings and Pensions Act) 2003 (ITEPA 2003), has rules regarding associated companies and s24A has rules regarding relevant and related employers.

34. Section 689, ITEPA 2003 (the host employer rules), imposes an obligation on the host entity to operate PAYE when the legal non-UK resident employer does not operate PAYE.

35. Could these two approaches be combined so that the obligation to operate PAYE falls on the employment company when the UC does not operate PAYE?

36. Could a similar approach be taken to deal with the issues of unpaid holiday pay, the cost of employer NIC transferred to the worker, etc?

Ch 3 – umbrella company standards

Question 4: What aspects of the umbrella company's role in the supply chain should the regulations cover?

37. At a bare minimum, employment rights including payroll, national minimum wage, right to paid holidays, etc.

Question 5: Is there a rationale for starting with limited regulations and reviewing them before potentially expanding them to cover other areas of umbrella company involvement? Please explain your answer and illustrate with examples.

38. Considering the issues that have been found, more than limited regulation is required.

39. Starting with limited regulation that then expands would create uncertainty and be more burdensome to comply with than a 'big bang'.

40. Any regulations should be reviewed to see whether they are having the desired effect.

41. As stated earlier, no regulations would be effective without sufficient resources to enforce compliance, as demonstrated by the lack of compliance with the original IR35 legislation.

Ch 3 – enforcement of umbrella company standards

Enforcement body vehicle

Question 6: Are there reasons that the Employment Agency Standards Inspectorate should not enforce umbrella company regulations? And if so, are there other bodies or approaches the government should consider? Please explain your answer.

42. We agree it would be sensible to have one enforcement body. Such a body will need to be adequately resourced and have a proven track record in effective enforcement.

43. The consultation document states that:

> "Its current preferred approach is to regulate umbrella companies through expanding the remit of the EAS, which already regulates employment agencies and employment businesses.".

44. Has there been any review of how effective the EAS is in regulating employment agencies and employment business? Given the critical role it would play in enforcement we believe that an independent review of its effectiveness should be commissioned before any decision

is made. This is not an implied criticism of the current role of the EAS – the review would be to assess its capability to deliver on a critical new role in a highly controversial area.

45. Additionally, if the EAS is to be given a larger remit, will it be adequately resourced to meet its new obligations? Many tax agents believe that HMRC is under resourced. HMRC's own data shows that it did not properly enforce – for whatever reason – the original IR35 regime. Giving the EAS the obligation to enforce will not be successful if its current resources are not expanded to cover any extended remit.

Question 7: Does the Employment Agency Standards Inspectorate have sufficient enforcement powers to regulate umbrella companies or would changes need to be made? Please explain your answer.

46. Please see answers to Q4 and Q5.

Nature of enforcement

Impact of enforcement approaches

Question 8: Should EAS mirror its current enforcement approach for employment agencies and employment businesses if it enforces umbrella company requirements? Please explain your answer.

47. Please see answer to Q6.

CHAPTER 4 – TACKLING TAX NON-COMPLIANCE IN THE CONTINGENT LABOUR MARKET

Ch 4 – Option 1: Mandating due diligence

General operation

Question 9: Do you agree that a requirement to undertake due diligence upon any umbrella companies which form part of a labour supply chain would reduce tax non-compliance in the umbrella company market, and to what extent?

48. Obliging businesses to undertake due diligence will be effective only if accompanied by effective enforcement. Confidentiality and the general data protection regulation (GDPR) can restrict the level of due diligence that can be undertaken. For example, when the off-payroll working legislation was introduced it was necessary to include legislation in s60H, ITEPA 2003 (see guidance in ESM10011A) because in the absence of such legislation the client could refuse to confirm its size.

49. We believe that the government needs to issue guidelines on what it views as reasonable due diligence of supply chains while maintaining confidentiality and complying with GDPR constraints. Any guidance would need to explain how far down the supply chain the due diligence must extend.

Question 10: Would a mandatory due diligence requirement focused on tax non-compliance also improve outcomes for workers engaged via umbrella companies?

50. It would depend on what the requirement involves but obliging businesses to undertake due diligence will be effective only if accompanied by effective enforcement.

51. We think that just focusing on tax non-compliance will not by itself improve outcomes for workers employed via UCs – regulation and enforcement needs to cover employment rights too.

Question 11: Which parties in a labour supply chain should be required to comply with a due diligence requirement?

52. This would depend on how the regulations are framed. For example, the law could require that each entity has to review (a) the whole supply chain, or (b) just the entities below them in the supply chain, or (c) just the next entity in the supply chain.

53. Categories (a) and (b) obviously contain duplication. The question is, if one entity has performed due diligence on its part of the supply chain, how much reliance can be placed on this by another entity in the supply chain? Care will be needed when framing the rules to ensure that undertaking due diligence does not become such an onerous administrative requirement that it makes British businesses uncompetitive.

54. Will the government keep a register of compliant organisations, or will it insist that UCs are members of professional bodies, such as Freelancer and Contractor Services Association (FCSA) and Professional Passport, and effectively outsource the due diligence?

55. Should a system similar to the construction industry scheme gross payment status be introduced so that any payments to an "unregistered" UC is subject to withholding?

Question 12: Which due diligence checks are most effective for identifying potential tax non-compliance in labour supply chains?

56. The most effective check would be for entities to be able to obtain confirmation from HMRC timeously that the business is up to date with its tax affairs and is registered (see answer to Q11).

Question 13: What due diligence checks could end clients or employment businesses be reasonably expected to carry out upon umbrella companies within their labour supply chains? Which tax heads should the checks cover (e.g. employer duties, VAT, Corporation Tax, etc.)?

57. Without changes to confidentiality rules and GDPR we cannot see how an entity other than HMRC can check whether employer duties and other taxes have been paid.

Question 14: What evidence would you expect would need to be retained, and for how long, to demonstrate that a due diligence requirement has been met?

58. A record of the checks undertaken and conclusions, which must be retained for six years.

Question 15: How could a mandatory due diligence requirement be designed to ensure that compliance burdens remain proportionate?

59. We suggest adapting HMRC's Supply chain due diligence principles guidance referred to on page 31 of the consultation document.

Question 16: What would be the appropriate level of penalty to ensure that the requirement is complied with and how should it be calculated?

60. There should be a greater penalty for repeat offenders; a points-based system similar to PAYE failures should be considered. There is a precedent for penalties where there has been a loss of tax. If we are considering non-payment of, for example, holiday pay, would the penalty be based on the holiday pay not paid plus the tax and NIC thereon? In severe cases, the penalty might be, say, 100% of the tax and NIC and other duties avoided, or even based on penalty scales for national minimum wage (NMW) breaches (NMW penalties can be a maximum of 200% of arrears capped at £20,000 per worker).

Question 17: What safeguards, if any, do you think would be required were a due diligence requirement to be introduced?

61. There needs to be a defence of reasonable care against any penalty and/ or debt transfer provisions. The penal provisions should not apply to innocent mistakes.

Potential impacts

Question 18: What impacts would this option have on the labour market and on the umbrella company market specifically?

62. Very little unless properly enforced.

Question 19: Would this measure lead users and suppliers of temporary labour to move away from the umbrella company model of engagement? If so, how would end clients and employment businesses engage workers instead?

63. It will depend on how difficult it is to fulfil the requirements.

Question 20: Do you have any other comments on the proposal to require a mandatory minimum level of due diligence checks upon umbrella company engagements? In particular, are there any further risks that the government should consider before deciding whether to take this option forward?

64. The biggest risk is that the rules are so onerous and any enforcement is ineffective so that compliant organisations withdraw from the market as they are not able to compete on equal terms.

Ch 4 – Option 2: Transfer of tax debt that cannot be collected from an umbrella company to another party in the supply chain

General operation

Question 21: Do you agree that, were this option to be pursued, it would address tax non-compliance in the umbrella company market, and to what extent?

65. Yes, but this option will be effective only if accompanied by effective enforcement.

Question 22: Would this option improve outcomes for workers engaged via umbrella companies?

66. This would only improve outcomes for workers if the debt transfer provisions do not apply just to PAYE not paid but also to the payment of holiday pay, transfer of the cost of employer NIC to workers, etc.

Question 23: In what circumstances do you think HMRC should be able to transfer an umbrella company's tax debt?

67. The debt should be able to be transferred to the people running the UC whether in statutory positions or shadow directors. The debt should also be able to be transferred to anyone colluding in the avoidance of tax etc, including to the worker where the worker has actively colluded in the avoidance.

68. Any legislation should be drafted to avoid transferring the debt to innocent parties. The standard of proof must be very high, as found in VAT and NIC personal liability notices.

Question 24: Do you agree that the tax debt should be transferred to the employment business which supplies workers to the end client, with transfer also possible to the end client in certain circumstances?

69. Where the employment business and the UC are connected, associated or relevant businesses, then the debt should be transferred. The debt should not be transferred when they are truly independent businesses. The debt should only be transferred to the end client in exceptional circumstances such as collusion with the employment business and/or UC.

Question 25: What processes would employment businesses and end clients use to identify tax risks within their labour supply chains?

70. Without changes to the law we cannot see how any entity other than HMRC can check tax risks in other unconnected organisations.

Scope

Question 26: Do you agree that this option should apply to employment taxes as set out above? Which other taxes could or should it apply to?

71. As the object of transferring a debt is to collect tax that is "not realistically collectable from a non-compliant umbrella company" (para 4.21), for the protection of the exchequer it would seem sensible for the transfer to apply to any tax debt.

Question 27: How should the government define the engagements to which this option would apply?

72. Linking the debt to engagements rather than the company may render debt collection more difficult where types of engagement differ.

Expected impacts

Question 28: What steps should businesses using umbrella companies take to assure themselves that they are engaging with a compliant umbrella company? How could the government support businesses to minimise the impact of these actions?

73. Does the government accept that checking that the UC is a member of a professional body such as FCSA or Professional Passport is sufficient? Would government have to vet any organisations claiming to be professional bodies? Would new professional bodies have to register with the government?

Question 29: Would businesses stop using umbrella companies as a result of the introduction of a transfer of debt? How many businesses would do this and what wider impacts would there be?

74. Some business probably would but all would think carefully about ensuring that their due diligence was up to standard.

Potential risks

Question 30: What safeguards, if any, do you think should be included if this option is taken forward?

75. There needs to be a right of appeal and a defence of reasonable care.

Question 31: Would this option change behaviour of businesses using umbrella companies in the way that the government expects?

76. This would depend on the publicity and the enforcement. If the due diligence regime is too onerous some business may just stop using UCs rather than move to reputable UC. When the off-payroll working rules were introduced a few years ago we saw that some organisations, rather than comply with the off-payroll working rules, stopped using personal service companies to avoid the administrative burden. We would expect organisations to undertake similar reviews and respond accordingly.

Question 32: How likely is it that the temporary labour market would move away from using umbrella companies entirely, were this option taken forward?

77. This depends on the administrative burden. If it was only that you had to ensure that you used a "registered" UC it is unlikely to lead to a move away from UCs. But if a full-scale review of a long labour supply chain is required, it is more likely to result in a move away from using UCs.

Question 33: Are there any further risks that the government should consider before deciding whether to take this option forward?

78. Please see answers to preceding questions.

Ch 4 – 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

General operation

Question 34: Do you agree that, were this option to be pursued, it would address tax non-compliance in the umbrella company market, and to what extent?

79. If the individuals who control both the employment business and the UC are the same individuals, the change will be ineffective because if the UC was not compliant why should we expect the employment business to be compliant?

Question 35: Were this option to be taken forward, which entity in the labour supply chain would be best placed to be the deemed employer, and why?

80. The employment business first then the end client.

Expected impacts

Question 36: How would businesses manage their obligations as deemed employers following this change? What could the government do to support them with these new obligations?

81. There would need to be clear guidance about what is expected. An issue with the off-payroll working rules is that the guidance is sometimes not clear, for example on outsourcing.

Question 37: Would businesses stop using umbrella companies as a result of this change? How many businesses would do this and what wider impacts would there be?

82. The experience of the introduction of the off-payroll working rules suggest that many business would just stop using UCs.

Potential risks

Question 38: How would the temporary labour market respond to this option being taken forward?

83. It is possible that it could shrink.

Question 39: Would this option improve outcomes for workers engaged via umbrella companies?

84. It may not if the UCs find that they no longer have any business because the administrative burden is too burdensome.

Question 40: Are there any further risks that the government should consider before deciding whether to take this option forward?

85. This may make British business less competitive.

Question 41: Are there any other options that have not been covered in this chapter that you think could reduce non-compliance in the umbrella company market?

86. Please see the Key Points and General Comments above. Certain individuals will come up with ways to get round the legislation. We saw this with the off-payroll working rules and we should expect it with these. The only way to stop this is to reduce the differential in tax and NIC that arise from different employment statuses.

CHAPTER 5 – TARGETED OPTIONS TO ADDRESS TAX NON-COMPLIANCE

Ch 5 –VAT flat rate scheme and MUC abuse option

Question 42: What more could HMRC do to prevent abuse of the scheme? Are there any specific options that you believe the government should consider?

87. The consultation states that:

> "HMRC saw a reduction in the flat rate scheme population after the [trader of limited cost] test was introduced but the scheme is still subject to high levels of abuse".

88. If HMRC is aware that the scheme is subject to high levels of abuse, it is presumably aware of the ways in which the scheme is abused and will be best placed to counter this.

89. We understand that there are two main ways in which the scheme could be abused:

    a) the selection of a lower flat rate than should be properly applied by the business; and

    b) the (likely fraudulent) creation of MUCs to allow the lower flat rate to apply to a higher value of turnover.

90. To combat the first type of abuse, HMRC should be conducting checks of the flat rate applied for. This could be compared to the VAT registration application, CH records, or online searches of the business. Where the information required is not freely available, additional evidence should be requested from the business, in the same way that HMRC requests additional evidence of an intention to trade from intending traders. These checks should be conducted using a risk-based approach, particularly targeting applications for the use of rates at the lower end of the FRS scale.

91. To combat the second type of abuse, automatic checks should be included in HMRC's system to flag VAT registrations or applications using the same bank account. We are aware that it is increasingly difficult for start-up companies to obtain a UK bank account, particularly if its directors are overseas. Therefore, it is unlikely that MUCs incorporated to abuse the FRS would all have unique bank accounts.

Question 43: What benefits does the scheme currently provide when compared to other accounting simplification measures (e.g. the annual accounting or cash accounting schemes) and, in particular, what additional (if any) benefits are there to those enabled by Making Tax Digital for VAT?

92. The primary benefit of the FRS is that small businesses do not have the administrative burden of complying with the rules for recovering input tax, including the obtaining of valid and correct VAT invoices for costs (except for capital purchases over £2,000).

93. Although the administrative easement may not be as significant as it was now that many businesses have digitalised their business records, this clearly still provides a benefit to small businesses. This is why (based on the latest figures we have seen from HMRC), around 260,000 businesses still use the FRS, which is roughly one in six eligible businesses.

Question 44: What effect, if any, has the 'limited cost' test had on your VAT accounting obligations?

94. Not applicable, as we are responding as a representative body. However, members report that it has reduced the number of VAT traders for whom the FRS is fiscally beneficial. As a result, we note that the number of VAT registered traders in the UK using the FRS has dropped from a peak of around 411,000 (31% of eligible traders) in 2015/16 to about 260,000 (17%) today (as noted in the answer to Q43).

Question 45: Do you have any other thoughts you would like to share on the VAT flat rate scheme?

95. The FRS was introduced in 2002 before many small businesses had digitalised their business records. Given the falling numbers of traders using the scheme and HMRC's assertion that the scheme is still subject to a high level of abuse, we recommend a review is conducted to establish whether it is still the most appropriate simplification for small businesses.

Ch 5 – employment allowance option

Question 46: Do stakeholders agree, that if this option were implemented, it would help address abuse of the employment allowance?

96. Limiting companies' EA claims to employers that have a UK director in post throughout the year would be likely to reduce the number of claims, but even a UK resident director might be no more than a puppet.
97. The efficacy of this proposal would be enhanced if HMRC could check with CH whether a director holds other directorships, and, if so, companies with common directors could be disqualified from claiming EA if they exceed the size criteria.
98. Similarly, HMRC could also cross-check shareholdings to CH data and eliminate those that are connected by virtue of common shareholdings and exceed the size criteria.
99. In addition, HMRC could cross-check bank account details to see if other employers use the same account. As we note in our answer to Q42, we are aware that it is increasingly difficult for start-up companies to obtain a UK bank account, particularly if its directors are overseas. Therefore, it is unlikely that MUCs incorporated to abuse the EA would all have unique bank accounts.

Question 47: Are there any ways in which mini umbrella companies could sidestep these changes, and if so, how could this proposal be strengthened to reduce or prevent this risk?

100. Covered in other replies in this section.

Question 48: For limited companies, how would your business be impacted if eligibility requirements were brought in that required your business to have at least one UK director in order to claim or continue claiming the employment allowance?

101. Covered in reply to Q46.

Question 49: Would there be any barriers to appointing a UK director for those legitimate businesses who do not currently have one in place but who are eligible to claim the employment allowance?

102. We have no comments here.

Question 50: Are there any wider benefits, impacts or risks involved with this proposal that have not been identified above?

103. Covered in the other replies in this section.

Question 51: Do stakeholders consider it would be beneficial to amend payroll software to make explicit that a UK director is required at the point of claiming the employment allowance?

104. Payroll software currently includes fields for directors' NIC (data items 84A & 84B) but these are used only if a director is paid a salary. Appointment and retirement of directors is a human resources concern and not a matter for payroll unless they are paid. If all directors were mandated to be included in payroll even if not paid (which would require not only software changes inter alia to allow £nil PAYE RTI full payment submissions but also legislation mandating payroll to report such details), then once the last UK director retired, the year's EA could be reversed in payroll.

105. Alternatively, with joined up government, HMRC could initiate a flag in CH's records to alert HMRC of the appointment and retirement of UK directors of companies claiming EA so HMRC could automatically disqualify a company from EA for the year where it has no UK directors and claw back the EA by telling the company to amend its PAYE submissions or adding a charge to the PAYE account.

Question 52: Aside from the proposed option and wider options discussed throughout this consultation, what more could HMRC do to reduce the abuse of employment allowance?

106. EA ameliorates the impact on small employers of the cost of secondary (employer) class 1 NIC. Employers currently when claiming EA have to grapple with the rules for subsidy control (formerly state aid, as still referred to in HMRC's guidance on EA eligibility) that few understand. We recommend that consideration be given to conducting a review to establish whether EA is still the most appropriate way to ameliorate NIC costs for small businesses, ideally alongside a wider review of the taxation of work, as recommended above in our Executive Summary, Key Points and General Comments.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).