PayePass

Shifting Sands

The cause, scale and implication of changes in the UK workforce engagement status 2019-23

CBI MEMBER 2023

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Introduction

Ever since I first got involved in the contingent workforce sector a decade ago, there has been a perception that it is a hotbed for tax non-compliance. Whether that is self employed people paying less tax than their employed colleagues (a regular political argument); businesses pushing the boundaries of legislative intent; or individuals creating tax schemes aimed at unsuspecting temps and contractors, it seems everyone is at it.

Even HMRC acknowledges that 99% of the tax avoidance market involves disguised remuneration schemes targeting contractors and agency workers.[1] It is well-known that these schemes masquerade as compliant umbrella companies, yet HMRC has consistently failed to tackle these companies. (HMRC's controversial loan charge policy targeted individuals with life-changing tax bills rather than dealing with the masterminds behind the tax arrangements.)

In a positive development, the government has recently issued a consultation[2] with options on how they might deal with non-compliance in the umbrella market. A transfer of debt will likely be brought in, meaning that recruitment agencies (and possibly end-clients) will be liable for unpaid tax and NICs arising from an umbrella going into liquidation. Fortunately, it is now perfectly possible to irrefutably prove the tax compliance of any umbrella that a worker/agency/client might want to work with, so the debt transfer risk is easily manageable through PayePass.

Neither HMRC nor the Office for National Statistics (ONS) appear to have a firm idea of the number of people working through umbrella companies who might be at risk of being lured into a tax scheme. This is a particular concern given the known impact of off-payroll reforms encouraged agencies and end-clients to engage their workers via umbrellas rather than personal service companies. There was a lot of anecdotal noise about the increase in umbrella working at the time of off-payroll reforms, but how true was this in reality?

Given the general lack of clarity, particularly on how contingent workers have fared in recent years, we commissioned evidence-based research to better understand this economically important population. In addition, we have particularly focused on the size, scale, and characteristics of the umbrella sector in order to provide evidence to support any regulatory decisions.

Julia Kermode
Chief Executive, PayePass Solutions

[1] https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk-2020-to-2021

[2] https://www.gov.uk/government/consultations/tackling-non-compliance-in-the-umbrella-company-market

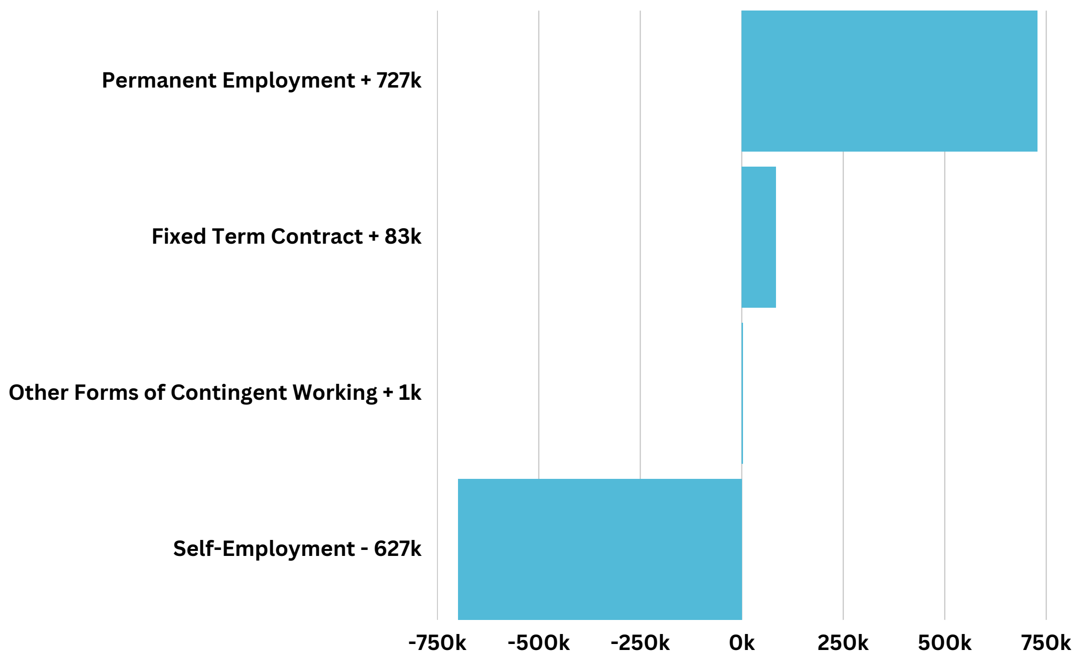
Executive Summary

More than one in five of the UK's workforce is contingent, i.e. working but not in permanent employment, and our economy relies on the flexibility of this population enabling businesses to survive during challenging times. And it's not just about surviving, the contingent workforce enables businesses to thrive, so it's important to understand this way of working.

We have analysed the cause, scale, and implication of changes in the UK's contingent workforce engagement from 2019 to 2023. Our findings show that self-employment is the powerhouse of contingent working and has been severely bruised by recent legislative reforms. Whilst numbers are slowly recovering (to 4.31m by Apr-Jun 2023), they remained 13.3% (616k) lower than in the quarter before the pandemic.

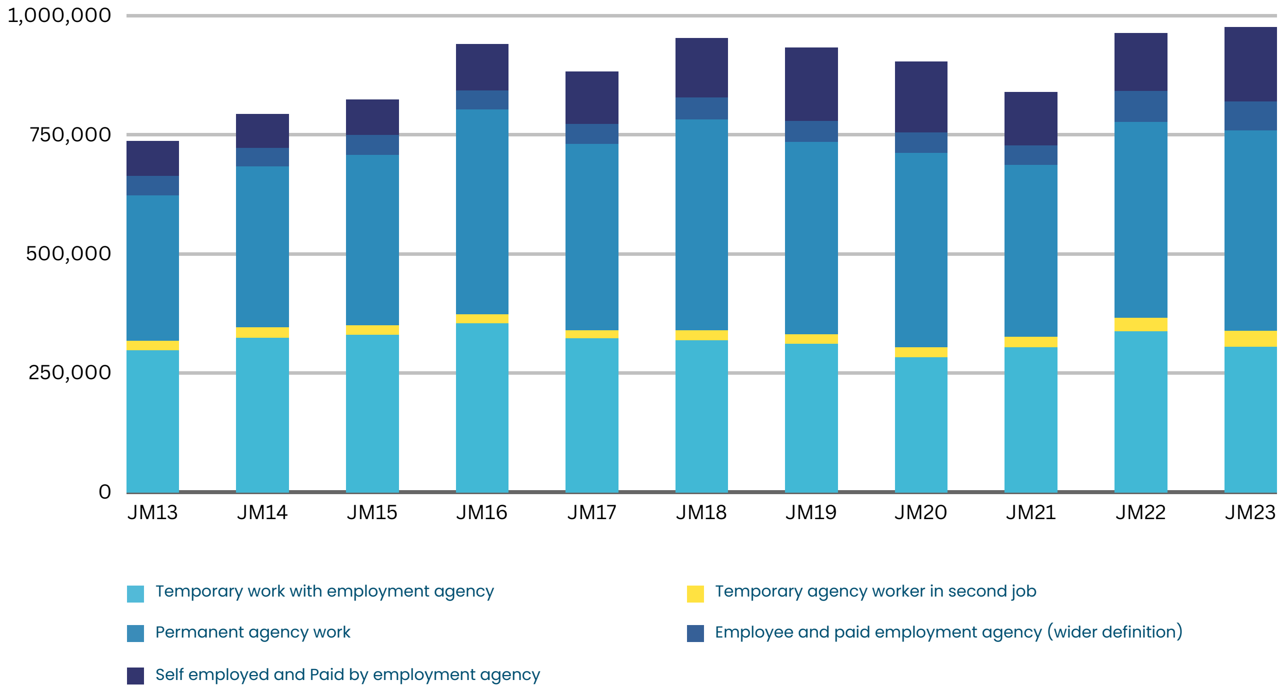
Whilst temporary employment is self-employment's 'flexible friend', it is a significantly smaller pool (1.62m) of people. The number of temporary workers notably rose between 2020 and 2023 and was 7.0% (106k) higher than in Q1 2020 – largely courtesy of an increase in fixed-term contract working. However, the increase in temporary employment did not absorb all self-employment losses.

The last few years have been turbulent for several reasons, and many people have changed how they work, including how they are engaged. Perhaps somewhat surprisingly given the impact of Covid, permanent employment was the clear winner of changes between 2019-22:



As such, despite all the noise surrounding the growth in umbrella employment (due to off-payroll reforms), the aggregate data shows the number of workers self-classifying into a variety of forms of agency-facilitated work. This evidences that there was an uptick, but certainly no net surge.

This is likely due to the loss of umbrella workers in some key sectors – as explored in the main report - where there was an overall downturn. We have also seen a surge in the capture of umbrella workers by larger service providers over smaller operators – likely as a consequence of increased hirer and agency moves to preferred supplier lists (PSLs).



From our analysis, we estimate an overall rise in umbrella worker numbers from c.600k in 2018/19 to c.700k in 2021/22. However, we believe that the rise in umbrella working has now peaked, particularly given the recent rise of self-employment suggesting that businesses are once again comfortable with engaging people directly in that way.

To assess the potential impact of the c.100k increase in umbrella workers, we have used the published accounts from 20 of the largest umbrella companies to determine some average metrics from which to run some calculations. Our findings are presented in Section 3, (page 24) and show that whilst turnover for these large umbrella companies increased substantially, their gross profit margin decreased significantly in the same period. This suggests that the margin has been lost to secure an increasing market share. If that is the case, it's a worrying trend because it makes it increasingly difficult for smaller umbrella firms and new entrants to compete.

Our findings also show that HMRC should have benefited from the increase in umbrella workers through the relative ease of collecting taxes through a few central facilitators. We have calculated some estimates of the impact on tax and national insurance revenue based on our estimated rise in numbers and the changed profile of umbrella workers – now much higher paid on average. There should also have been a correspondingly large increase in pension fund accruals.

Interestingly, employers in the north seem to have embraced umbrella working in response to legislative reforms more than employers in the south, where the adoption of fixed-term contract working was prevalent. There also appears to have been high levels of umbrella working adoption in sectors and occupations where it was not previously prevalent – notably within the care sector.

With the swell in umbrella worker numbers created largely through the transition of higher-paid former PSC workers (with no choice) into this engagement status category, the pool of workers seeking to optimise their take-home pay has increased - and fundamentally altered.

There were differences in the behaviour patterns amongst former personal service company (PSC) contractors based on whether or not they were able to enact personal choice. The surge in retirement around the time of the off-payroll reforms in 2021 suggests that umbrella working was not an acceptable alternative for workers who had a choice. As a consequence, UK plc. will have lost access to scarce skills that it could not afford to lose.

Our Findings

Whilst there has been a net surge in the number of umbrella workers due to the off-payroll legislative change, the increase was not as large as the noise suggested. Moreover, our evidence suggests that the rise in umbrella working has now passed its peak, so savvy umbrella companies will need to focus their strategy on how best to retain their workers and minimise churn. Worryingly, the stark downward trend in umbrella company gross profit margins (decreased by 50% since 2018/19) leaves little headroom for investment or innovation.

Additionally, the money is simply not available within compliant umbrella companies to sustain the current levels of financial incentives paid to recruitment companies in exchange for referring workers to them, nor paying large sums to be included on preferred supplier lists.

The omnipresence of commissions makes it difficult for smaller umbrella companies to compete with larger businesses because they simply do not have the financial bandwidth to be able to do so. It is clear to us that the financial incentivisation of recruitment companies to recommend umbrellas is spiralling out of control, and is simply not sustainable for compliant umbrellas.

There have long been concerns about the compliance of the umbrella sector, and given the volume of tax that should be collected from the sector, it is remarkable that the government has still not imposed statutory regulation. Fortunately, there are now positive moves in this direction, however no projected timeframe for change.

The increasing frequency of dubious practices hitting the headlines means there is a risk of a government decision to eradicate umbrellas entirely, rather than regulate the sector. However, simply paying lip service to raising standards and being compliant is no longer enough, it needs to be proven. This is now in everyone's interest to do so. Otherwise, continued false claims of compliance will only exacerbate mistrust of the umbrella sector and ultimately could bring about its demise.

Section One

An overview of the shifting sands of contingent working in the UK

Self-employment: the power engine of contingent working

Self-employment has become the power engine of contingent working in the UK, growing steadily after the last recession through to its peak in 2019. Whilst notably dented by events that we chart in this report, IPSE estimates that "the solo self-employed sector contributed an impressive, estimated figure of £278 billion to the UK economy" in 2022.[3]

Moreover, not once since the onset of the last financial crisis has self-employment not made a positive contribution towards workforce growth (against the Q3 2006 baseline). Proportionally, the impact of self-employment diminished significantly in 2020 and 2021 but started to increase again from Q1 2022.

Figure 1. Change in employed and self-employed workers in their main job, compared to Q3 2006

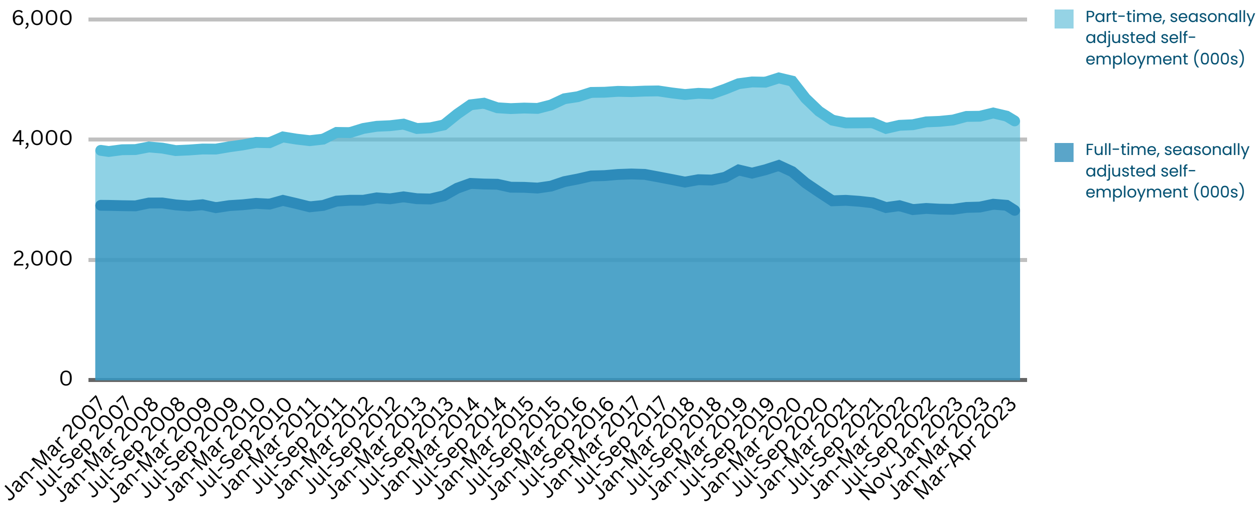
Source: PayePass analysis of ONS Labour Force Survey data

Peaking at 15.3% of the UK workforce in November 2019–January 2020, full and part-time seasonally adjusted self-employment fell, both in number and as a proportion of the total workforce across 2020. It largely plateaued across the first three quarters of 2021 before falling again in Q4. Numbers started to rally again in 2022 and early 2023, before dipping again in Q2 2023. By April-June 2023, self-employed numbers were:

- Up 0.8% (32k) on a two-year trend,
- Up 1.5% (63k) year-on-year, but
- Down 1.8% (78k) quarter-on-quarter (versus January-March 2023).

As a proportion of the total workforce, however, self-employment had only been restored to 13.1% by Q2 2023. Numbers also remained 13.3% (616k) lower than in the quarter before the pandemic (Q1 2020).

Figure 2. Full and part-time self-employed workers in their main job, to April-June 2023



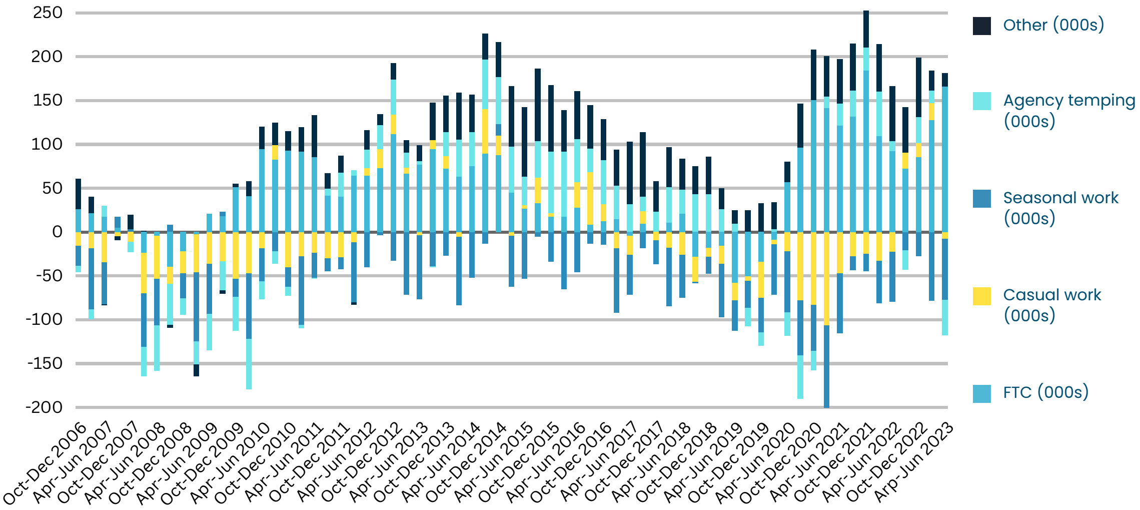
Source: PayePass analysis of ONS Labour Force Survey data

[3] https://www.ipse.co.uk/resource/self-employed-landscape-report-2022.html

Temporary employment: self-employment's flexible friend

Whilst much smaller than the self-employed worker pool, in terms of numbers – typically hovering between 1.3-1.6 million – and GVA output (£42.9bn in 2021)[4] a decline in temporary employment has long been a Canary-in-the-Mine for recessionary times. Once again, using the backend of 2006 (Q3) as the baseline, temporary employment slipped back into negative territory from Q1 2019 onwards. From Q4 2020 onwards, however, it was back in positive territory and, in Q4 2021, was higher than at any period since Q4. 2014.

Figure 3. Change in non-seasonally adjusted temporarily employed workers (by self-classified type) in their main job, compared to Q3 2006

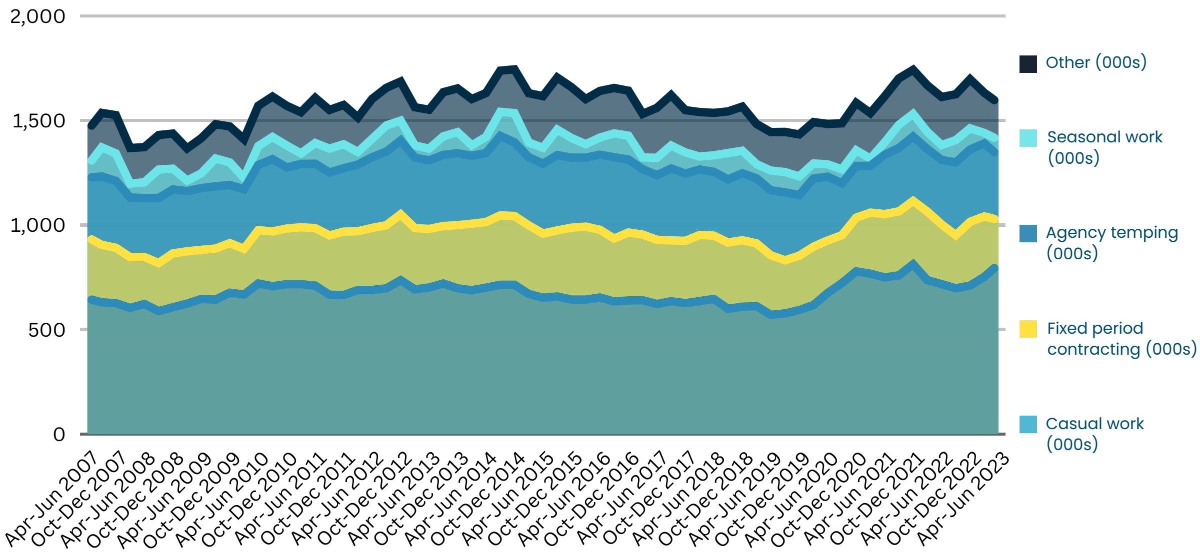


Source: PayePass analysis of ONS Labour Force Survey data

Having been an invaluable source of labour during the early stages of the pandemic, temporary employment had another surge as the impact of the private sector off-payroll working reforms took effect in 2021. The increase was due to tens of thousands of formerly self-employed personal service company (PSC) contractors needing another means of engagement to satisfy risk averse clients.

Since then, numbers have ebbed and flowed – falling back sharply in Q1 and Q2 2022, before picking up again in Q3 and Q4. Numbers remained relatively steady in the early part of 2023, and by April-June 2023, seasonally adjusted numbers were a notable 7.0% (106k) higher than before the pandemic (Q1 2020).

Figure 4. Temporary employees in their main job (non-seasonally adjusted), by self-classified type, to April-June 2023



Source: PayePass analysis of ONS Labour Force Survey data

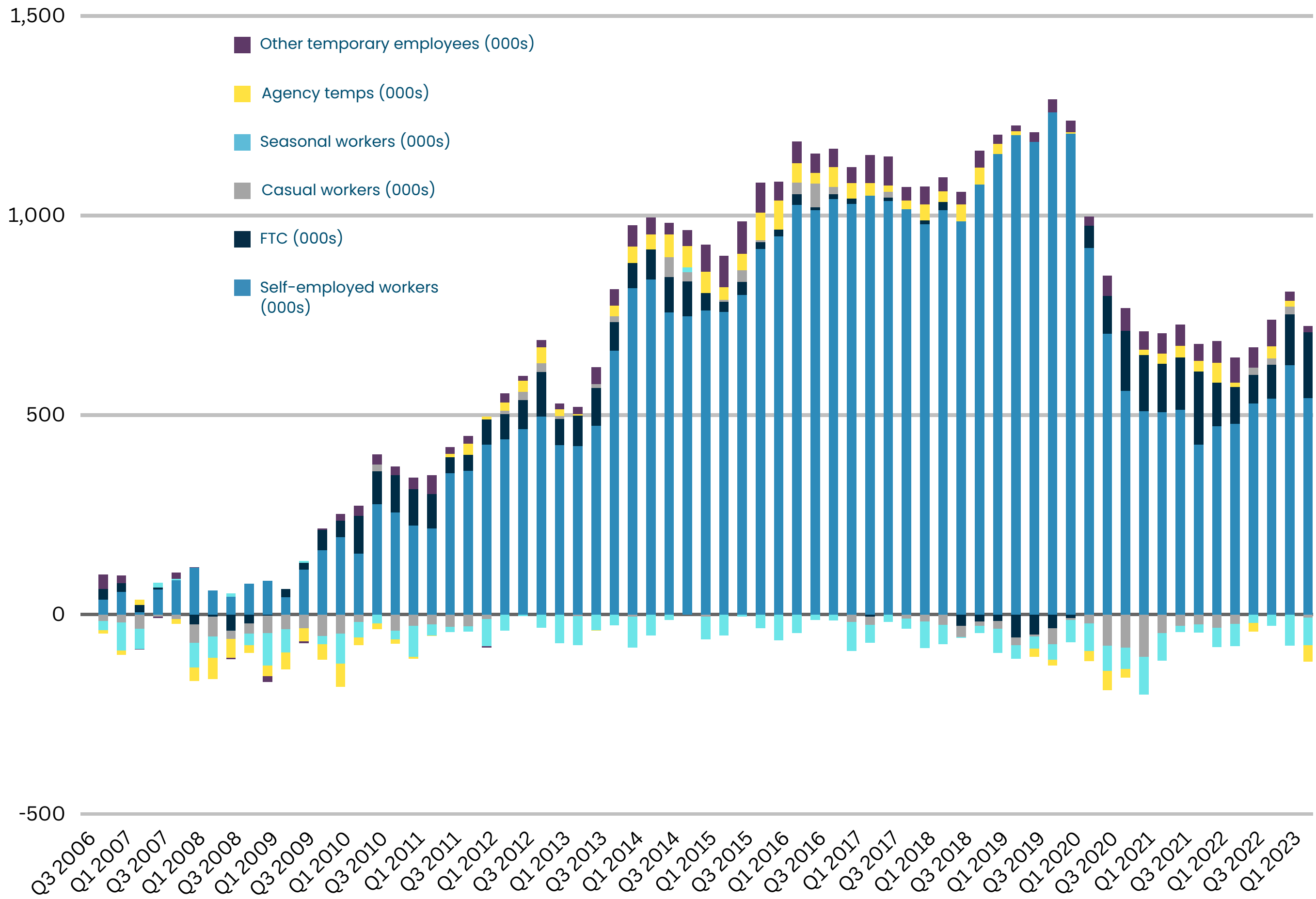
[4] REC, Recruitment Industry Status Report 2021/2022

Moves between contingent engagement status – and the pivotal role of umbrella companies

With the ability of contingent workers to move with relative ease between different forms of engagement, it is interesting to note how numbers have changed, by engagement type, since the last official recession. Until the onset of the pandemic and the UK's departure from the EU - both of which resulted in the loss of significant numbers of self and temporarily employed workers from the UK shores – self-employment was the standout winner in terms of contingent employment status adoption.

Since the false start (April 2020) and implementation of the off-payroll working reforms in the private sector (April 2021), however, fixed-term contract (FTC) working and 'Other' forms of temporary employment (likely including many umbrella workers) have officially come to the fore – clearly, to some extent, at the offset of some former self-employment.

Figure 5. Change in self-employed and temporarily employed workers (by self-classified type) in their main job, compared to Q3 2006



Source: PayePass analysis of ONS Labour Force Survey data

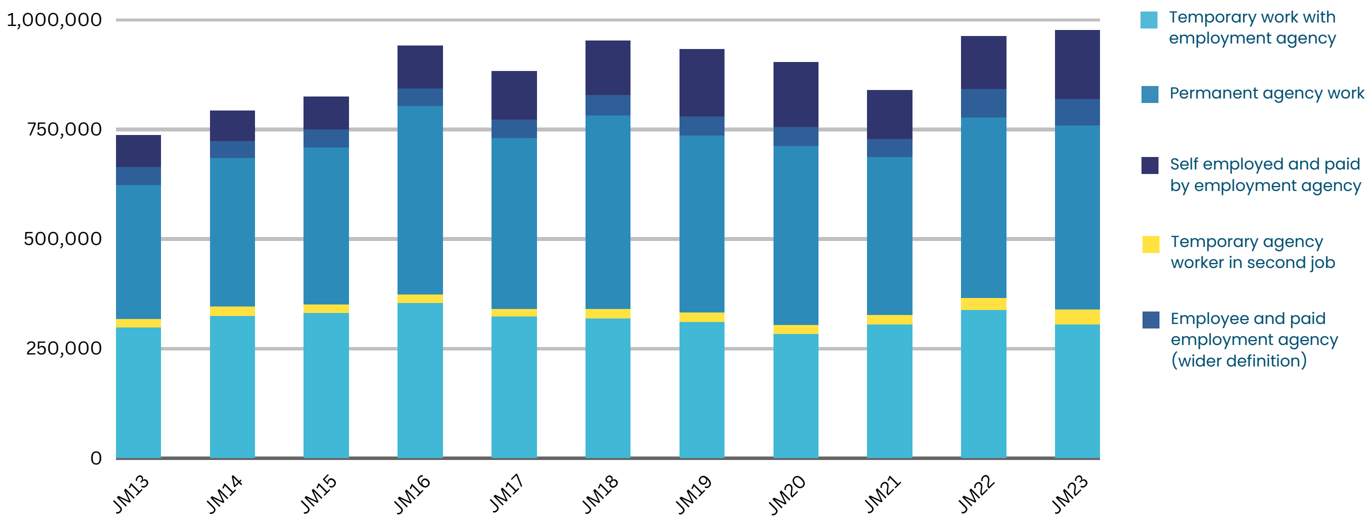
Beyond these official self-classified forms of contingent working, however, is another category of notable interest: the 'Permanent Agency Worker'. And, as these workers differ from employees of the agencies themselves, it is another pool which a significant number of umbrella workers potentially self-classify themselves into.

And whilst this pool was historically believed to have captured many workers placed on Swedish Derogation contracts, as a consequence of the Agency Worker Regulations implemented in 2011, this model was increasingly replaced by umbrella employment - notably so when the travel & subsistence rules changed in 2016. Moreover, Swedish Derogation was outlawed in April 2020, (by being removed from the Agency Worker Regulations) - potentially impacting up to "8-10% of UK agency workers" whom the UK government believed were engaged via the model.[5]

[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767354/RPC-4314_1_-BEIS_The_Agency_Workers__Amendment__Regulations_2019_-_revocation_of_the_Swedish_derogation_-_IA_f_-_opinion.pdf

In terms of the likely impact of the off-payroll reforms on umbrella employment, the Permanent Agency Worker pool rebounded post-pandemic but not to the extent suggested by all of the 'noise' around PSC movement to umbrellas. Moreover, data for Q1 2023 suggests that this pool plateaued and that the number of self-employed workers facilitated into work by agencies was, once again, on the rise.

Figure 6. Agency worker pool composition estimates, Q1 2013-23



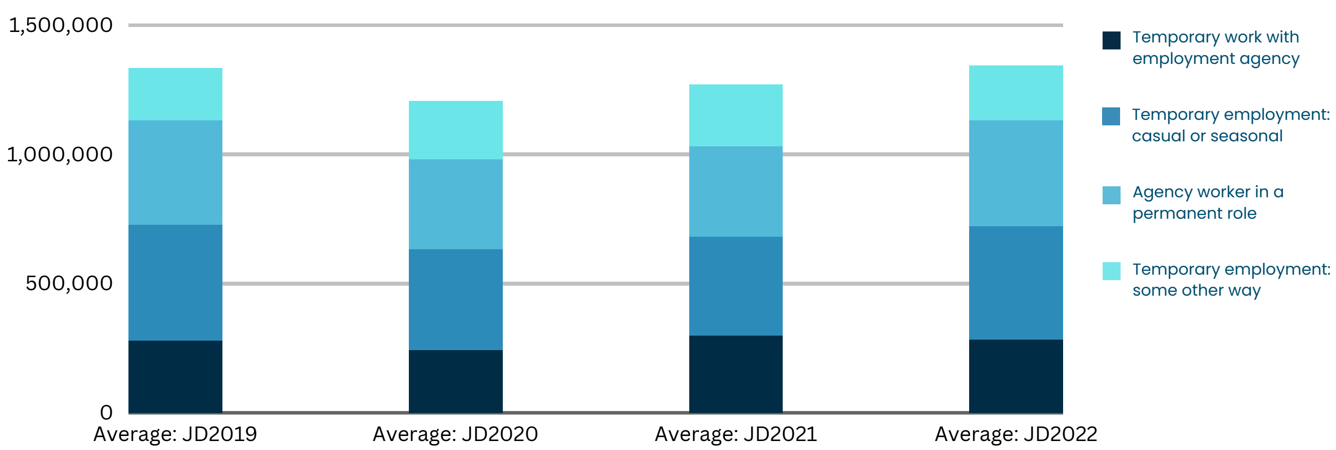
Source: PayePass analysis of ONS Labour Force Survey data

As most - but not all - umbrella workers are aligned to agencies, this analysis serves as useful in capturing the maximum potential pool that will include umbrella workers – regardless of how they choose to self-classify.

Beyond agency facilitated workers there are additional scenarios in which umbrella working has become an engagement model of choice for employers. Increasingly this is in MSP / RPO facilitated contract arrangements, including those that cover seasonal, casual, and other temporary employee arrangements. These differ from agencies as MSPs/RPOs largely do not source workers themselves, instead, they facilitate the engagement of workers sourced by others. Examples include the managing agents of NHS staff banks and large blue-collar worker pools.

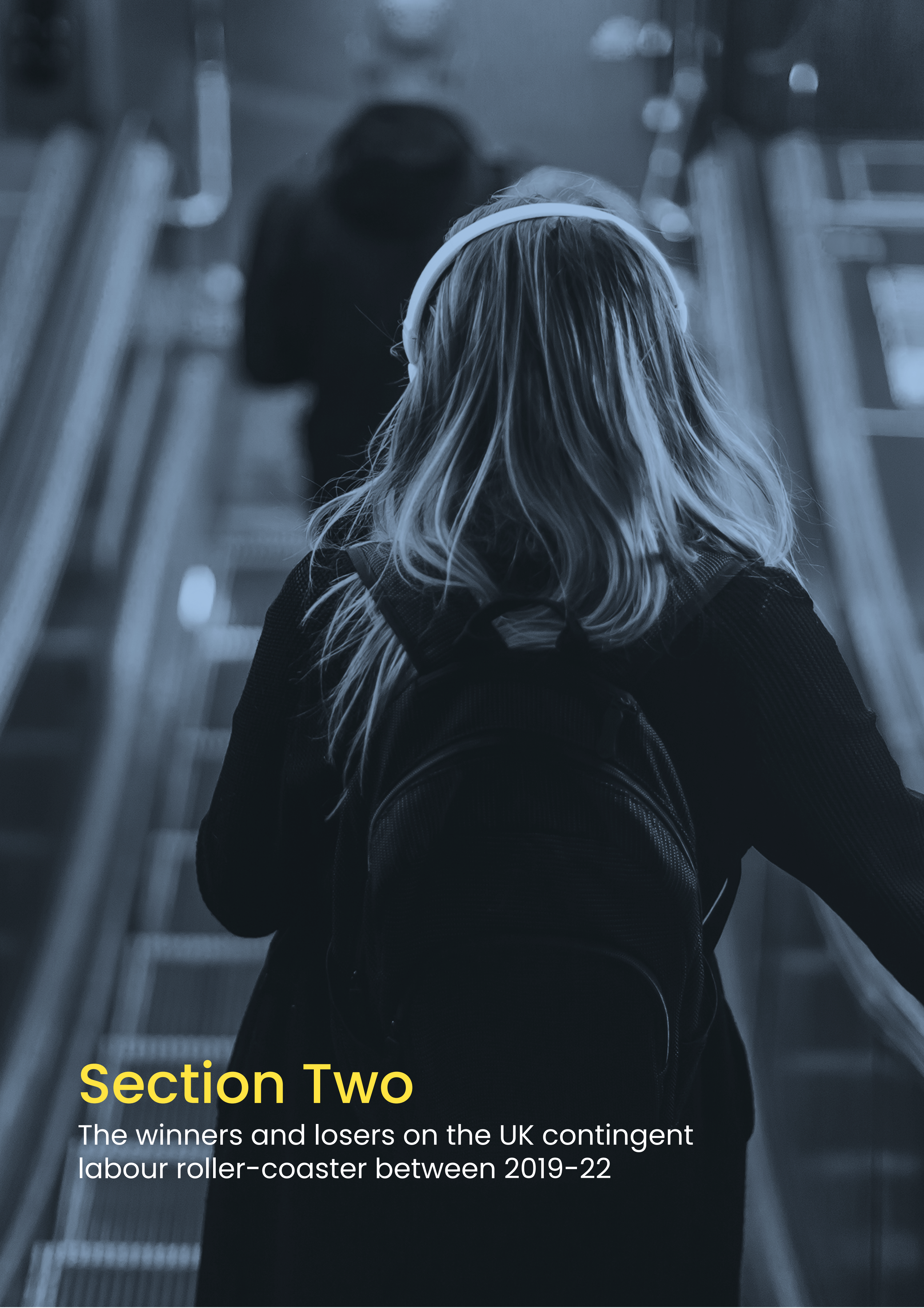
As such, there are four cohorts of notable interest when considering the maximum potential pool within which the totality of umbrella workers will sit: temporary agency workers, permanent agency workers, seasonal/casual workers, and 'other' temporary employees:

Figure 7. The potential self-classified contingent worker pools likely to capture umbrella employees



Source: PayePass analysis of Labour Force Survey and Annual Population Survey data

Within the next chapter, through analysis of the demographic changes to these four groups – and the notable cohort working on temporary fixed-term employment contracts - we have sought to shed light on the true impact of the changes to the private sector off-payroll working reforms in 2021, the likely flows between engagement status and the implications of those changes.



Section Two

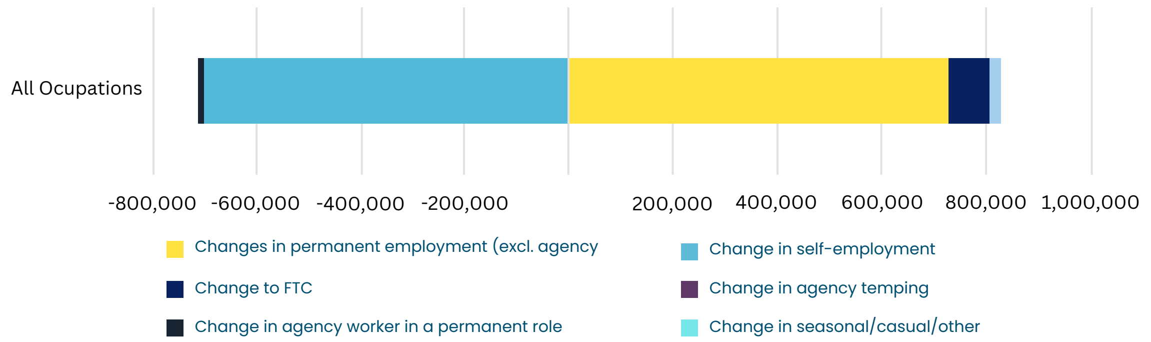
The winners and losers on the UK contingent labour roller-coaster between 2019-22

Contingent workforce in the UK between 2019-22

At an average of 32.7m in 2022, the UK workforce was broadly similar to the average throughout 2019. As such, swings between the underpinning workforce engagement status suggest a shift in hirers' preferred means of worker engagement, rather than to satisfy an increase or decrease in overall demand.

Self-employment was the clear casualty in contingent labour utilisation over the 2019-22 period. In contrast, permanent and fixed-term contract (FTC) employment surged:

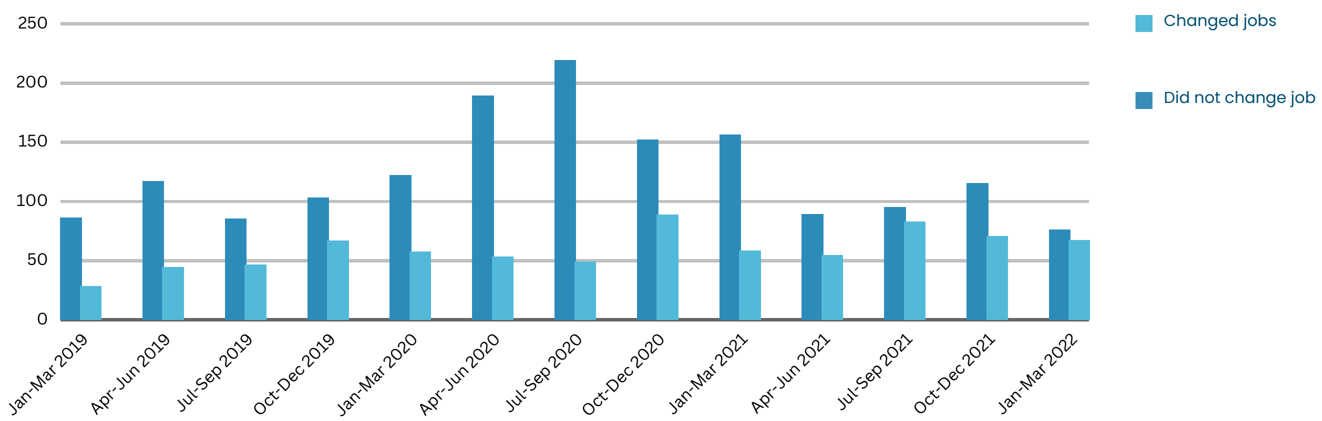
Figure 8. All enterprises: permanent & contingent labour movements, 2019-23



Source: PayePass analysis of ONS Annual Population Survey data

By way of the first important underpinning factor behind this trend, a moment-in-time peculiarity occurred around both the period of the aborted start of the private sector off-payroll working reforms in April 2020 and that of their actual implementation in April 2021. Unusually high numbers of formerly self-employed workers changed their engagement status to some type of employment whilst remaining in the same job.

Figure 9. Flows of people aged 16 to 64 years from self-employment in the previous quarter to employee status by whether or not they changed job (not seasonally adjusted), Jan-Mar 2019 to Jan-Mar 2022

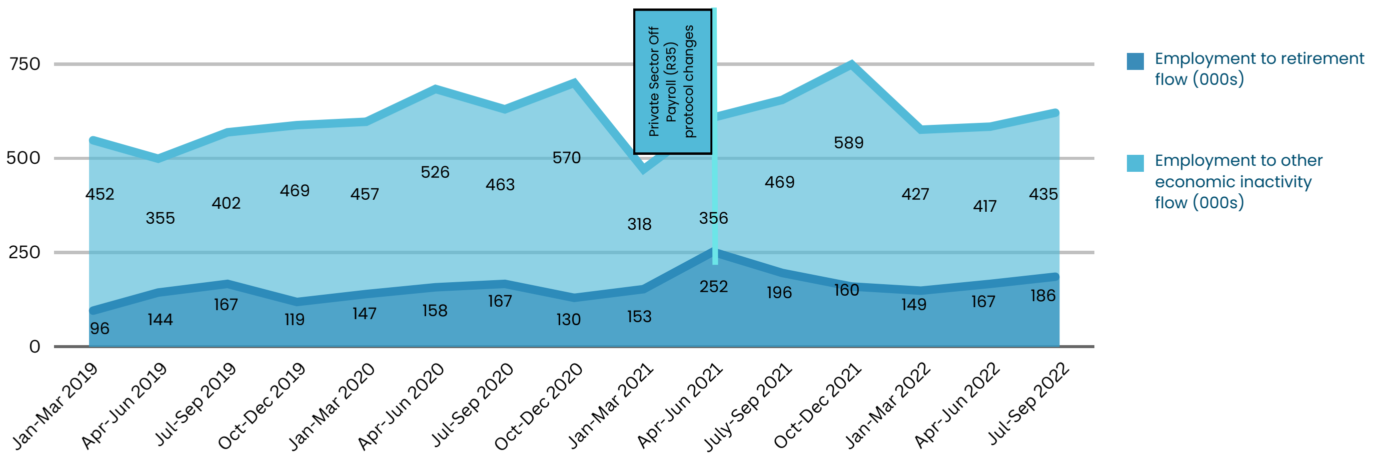


Source: PayePass analysis of ONS Longitudinal Labour Force Survey data

NB: People who did not change job ("reclassifiers") are defined as those who changed from self-employed to employee but stated they have been continuously employed in their same job for 3 months or more.

Secondarily, a further contributor to the loss of self-employed workers around the time of the actual implementation was the impact of the choice, by significant numbers, to retire.

Figure 10. Employment to retirement and other forms of economic activity, Jan-Mar 2019 to Jul-Sep 2022

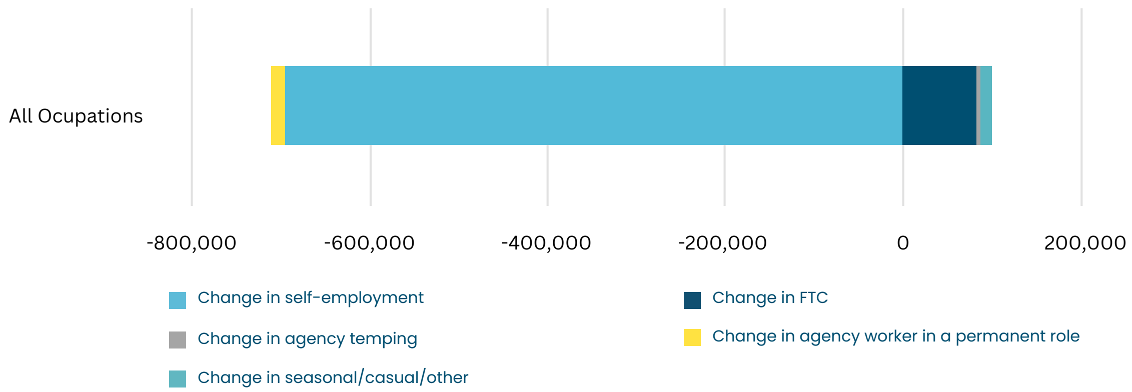


Source: PayePass analysis of ONS Longitudinal Labour Force Survey data

With these two driving forces considered - coupled with the relatively small net gains within other 'contingent' engagement status cohorts - it is clear that permanent employment was the key beneficiary of the shift away from self-employment. The uptick in FTC working is also noteworthy.

As anecdotal insights and umbrella company accounts evidence, however, two waves of significant movement out of PSC working into umbrellas also occurred around the time of the aborted private sector off-payroll working reforms in April 2020 and its eventual implementation in April 2021. The three-year comparison data suggests though, that demand from hirers and/or acceptance of this form of working by contractors may now have plateaued, if not reduced from its reform-driven peak.

Figure 11. All enterprises: contingent labour movements, 2019-23



Source: PayePass analysis of ONS Annual Population Survey data

Research[6] by Qdos evidenced that, in 2021, 94% of workers engaged via umbrella companies reported that they had no choice but to work through this contractual nature.[3] In the same report, Qdos also noted that 69% of contractors said they did not want to work via an umbrella company.

What is also clear from analysis of the underpinning demographic data is that the transitionary pattern between worker engagement types was not uniform and varied notably by geography, size of occupation, industry, and occupation.

[6] https://www.qdoscontractor.com/press-centre/research

Contingent labour movements: by region

When comparing the patterns of change between the northern and southern regions of England, there are two key notable differences:

- There was a sharp increase in the number of agency workers in a permanent post in the north, coupled with a notable increase in Seasonal/Casual/Other forms of temporary employment – both believed, as evidenced earlier, to include self-classified umbrella workers. In contrast, there was a notable decline in the former in the south.
- There was also a notable rise in the number of workers on a fixed-term contract in the south, compared to a negligible increase in the north.

Figure 12. All enterprises, by region: permanent & contingent labour movements, 2019-23

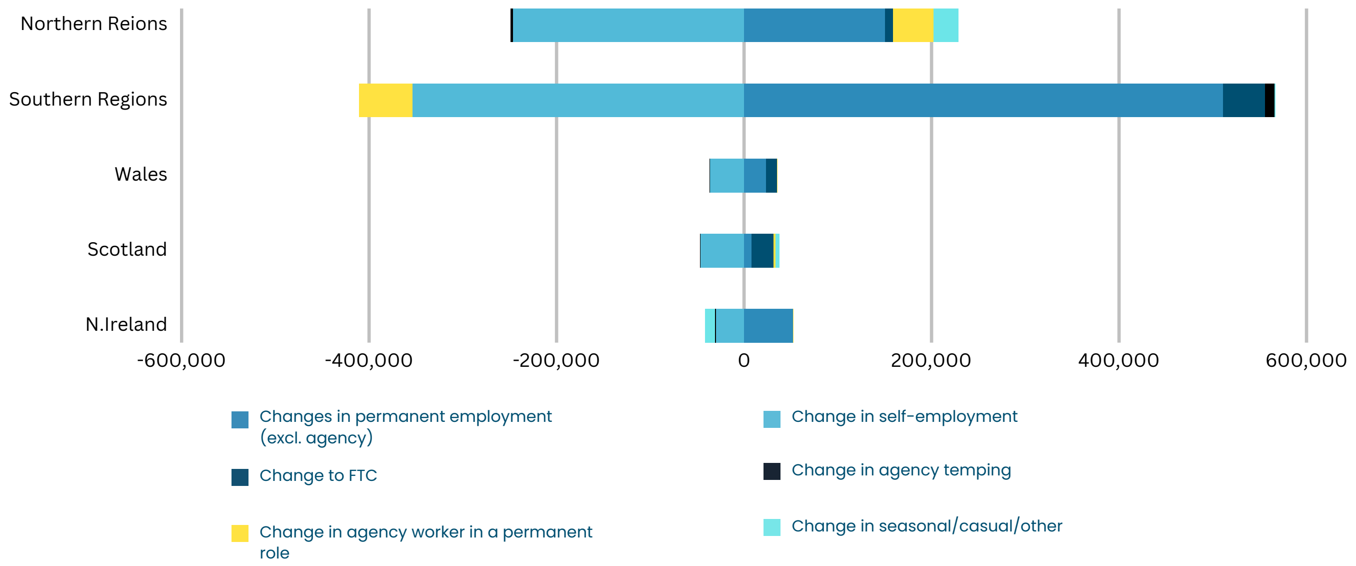
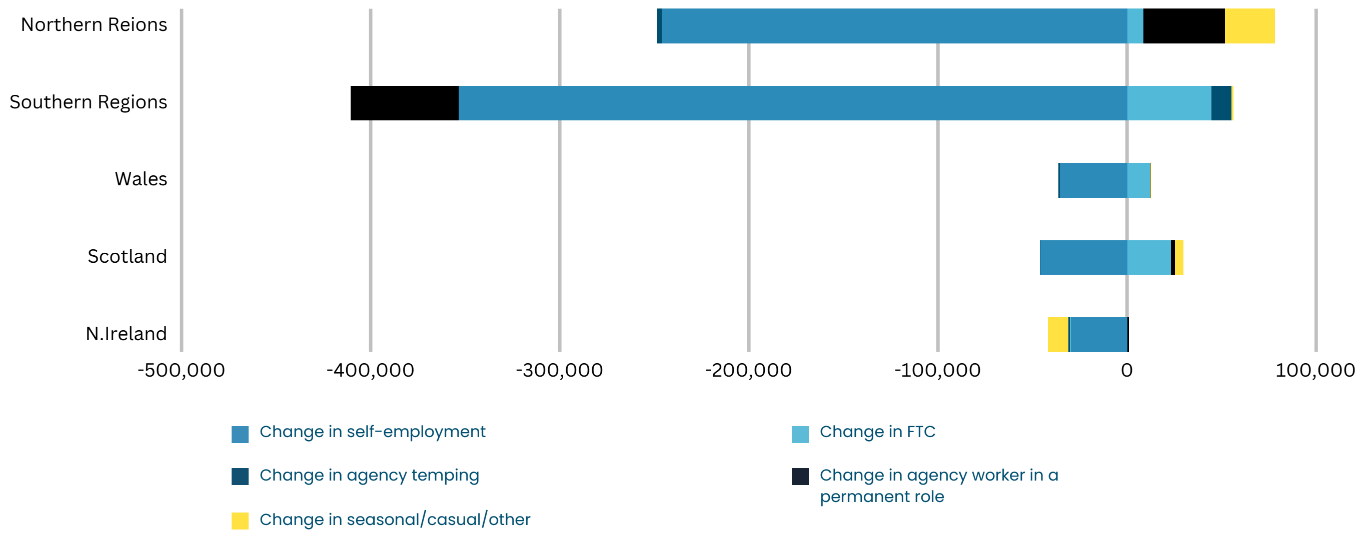


Figure 13. All enterprises, by region: contingent labour movements, 2019-23



Source for Figures 12 & 13: PayePass analysis of ONS Annual Population Survey data

As such, there appears to be a north/south divide in the pattern of movement between different forms of contingent work, pointing towards a potential spike in umbrella working in the northern regions of England - notably the North-West and Midlands – and a tail-off within the south – notably in London and the South-East.

Contingent labour movements: by size of organisation

Whilst no data is available to profile the self-employed worker engagement by size of employer, the changing picture from all other contingent worker data sets shows where there were notable gains and losses.

- Amongst micro and small enterprises – those currently not responsible for determining the employment status of contingent workers – significant permanent employment losses were offset by increases in all forms of contingent labour, that we have visibility on, over the period. This includes agency workers in a permanent role and seasonal / casual / other temporary employment – both likely to contain umbrella workers. As such, even though the off-payroll working changes were not intended to impact this significant group of employers, there is potential that awareness of changes within larger employers had some influence on micro and small company behaviours.
- Within 50-499 employee organisations, Fixed-Term Contract working was the net contingent beneficiary over the last 3 years.
- And amongst the largest (500+ employee) enterprises, FTC and Seasonal/Casual/Other temporary employment were the key beneficiaries, at the expense of agency working (temping and in a permanent role)

Figure 14. All enterprises, by employee size: permanent & contingent labour movements (excluding self-employment as N/A), 2019-22

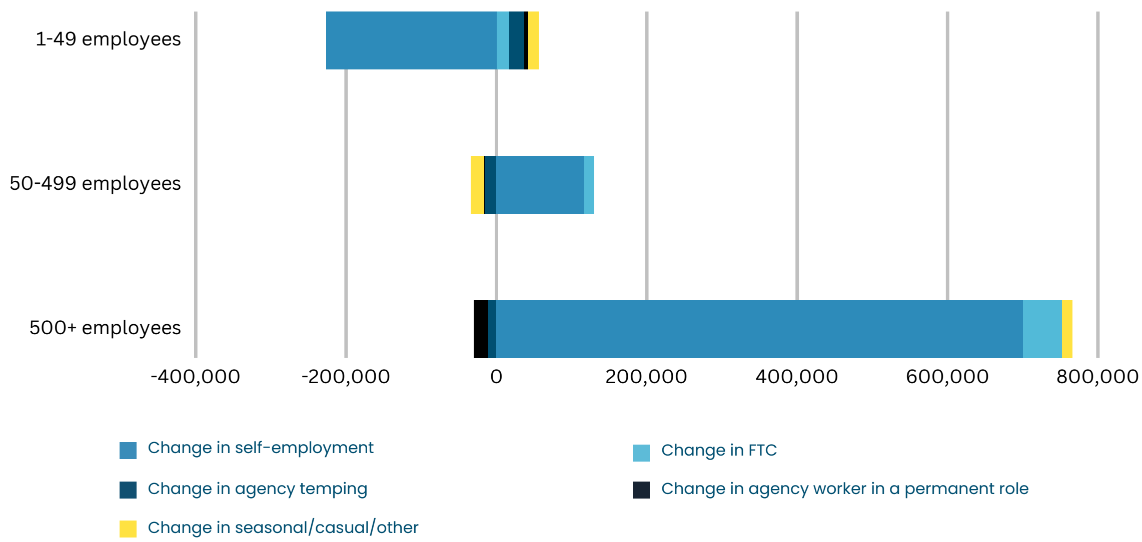
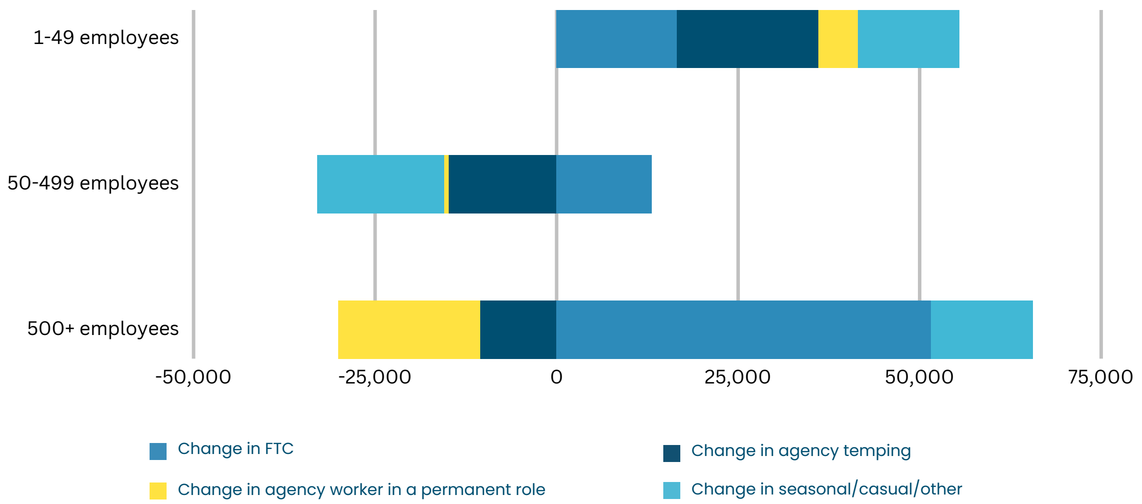


Figure 15. All enterprises, by employee size: labour movements (excluding self-employment as N/A), 2019-23

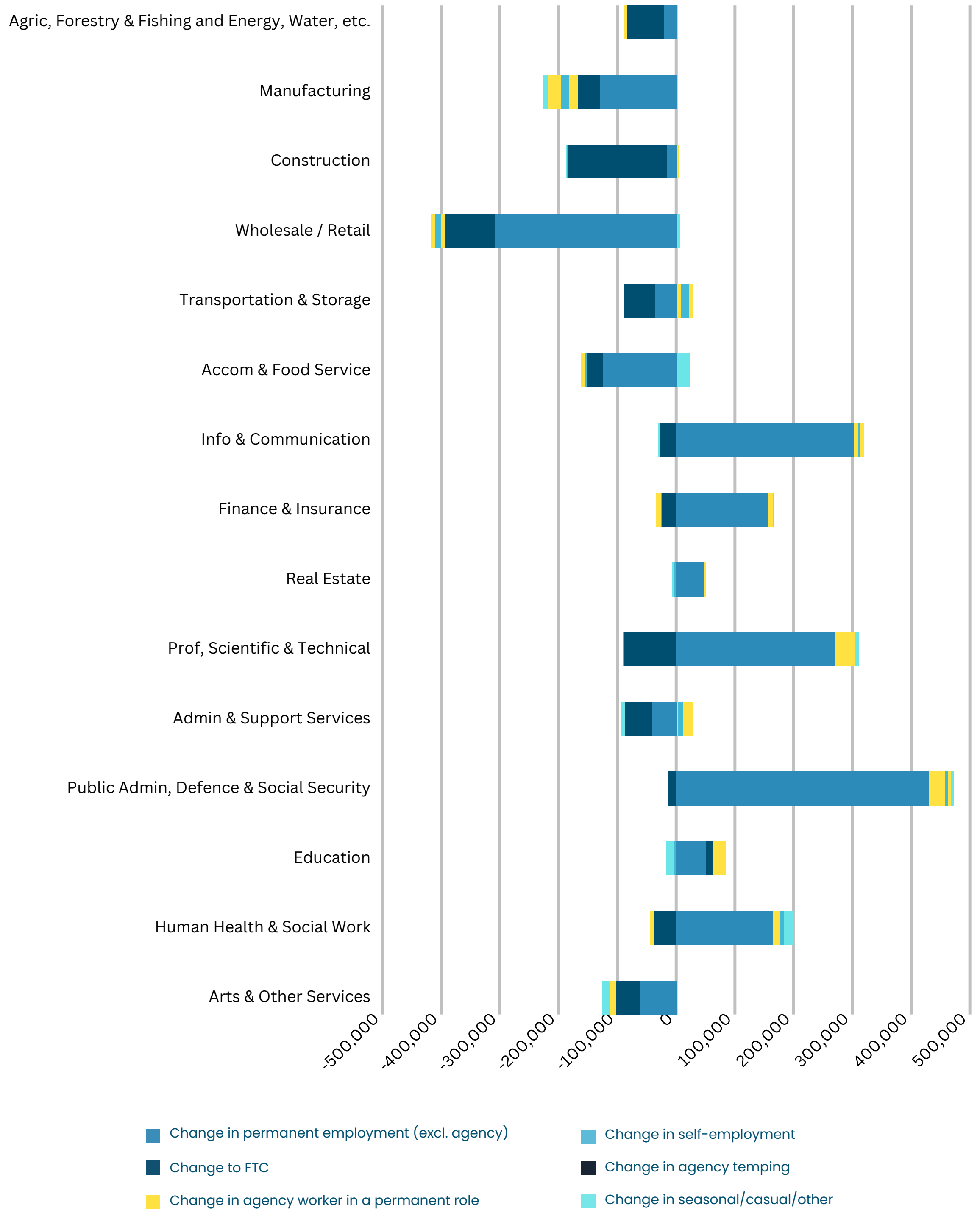


Source: PayePass analysis of ONS Annual Population Survey data

Contingent labour movements: by industry

Whilst several sectors witnessed a notable decline in overall employment – including Manufacturing, Construction, Wholesale/Retail and Accommodation and Food Service – others witnessed notable growth (including Information & Communication and Professional, Scientific, and Technical sectors as well as all key public service industries).

Figure 16. All enterprises, by industry: permanent & contingent labour movements, 2019-23



Source: PayePass analysis of ONS Annual Population Survey data

When considering the size of some of the sectoral declines in Agency Workers in a Permanent Role and Casual/Seasonal/Other temporary employees, however – which inevitably included the loss of umbrella workers within the mix – it is clear that their loss tempered significant surges elsewhere.

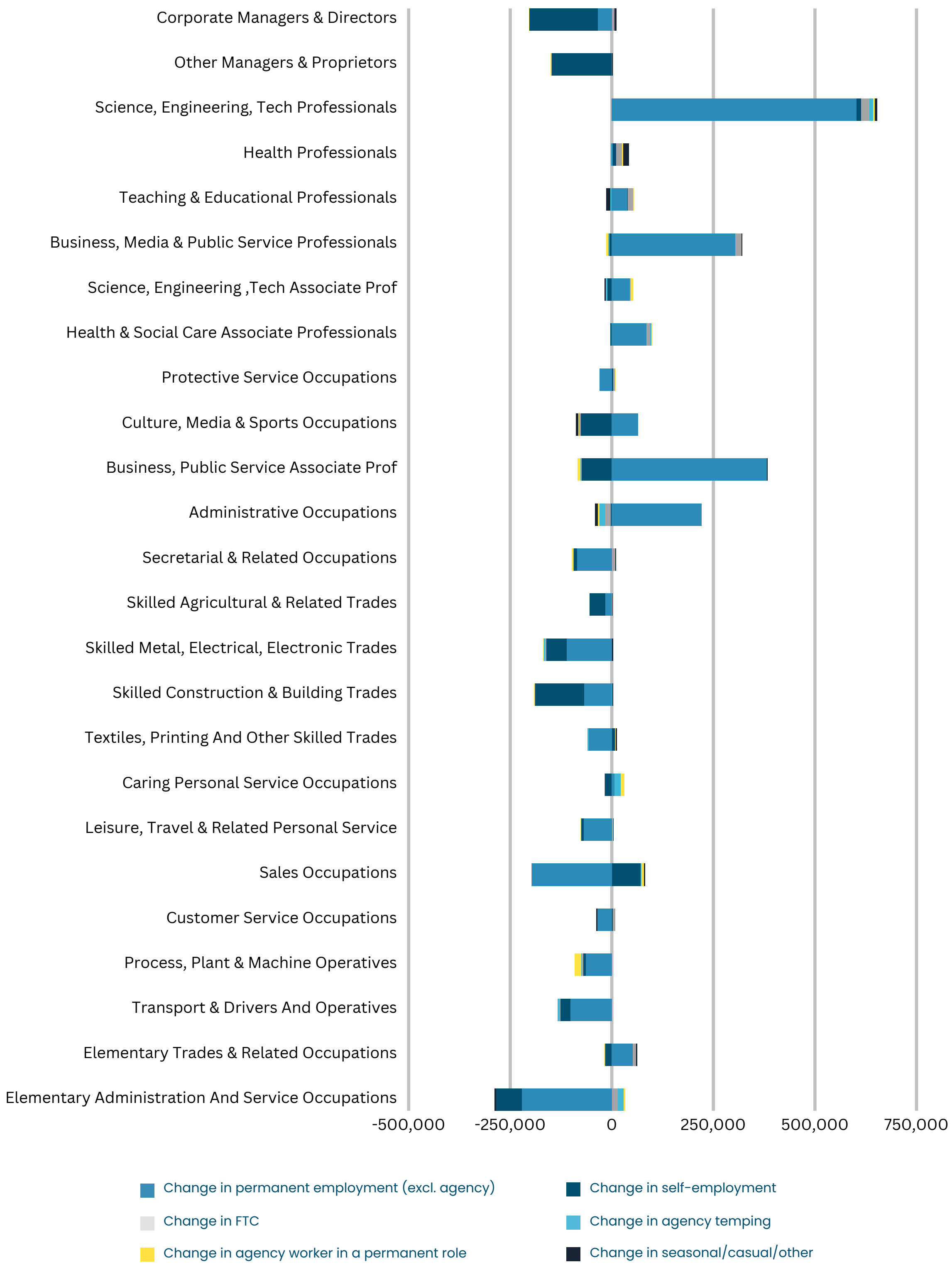
Figure 17. All enterprises, by industry: contingent labour movements, 2019-22

Source: PayePass analysis of ONS Annual Population Survey data

Contingent labour movements: by occupation

Similarly, whilst several occupations witnessed a notable decline in overall employment – including Managers, Directors & Senior Officials, Skilled Trades and Transport, Drivers, and Operatives – others witnessed notable growth (including Science, Engineering & Technical Professionals, Business, Media & Public Service and Health & Social Care Associate Professionals).

Figure 18. All enterprises, by industry: permanent & contingent labour movements, 2019-23



Source: PayePass analysis of ONS Annual Population Survey data

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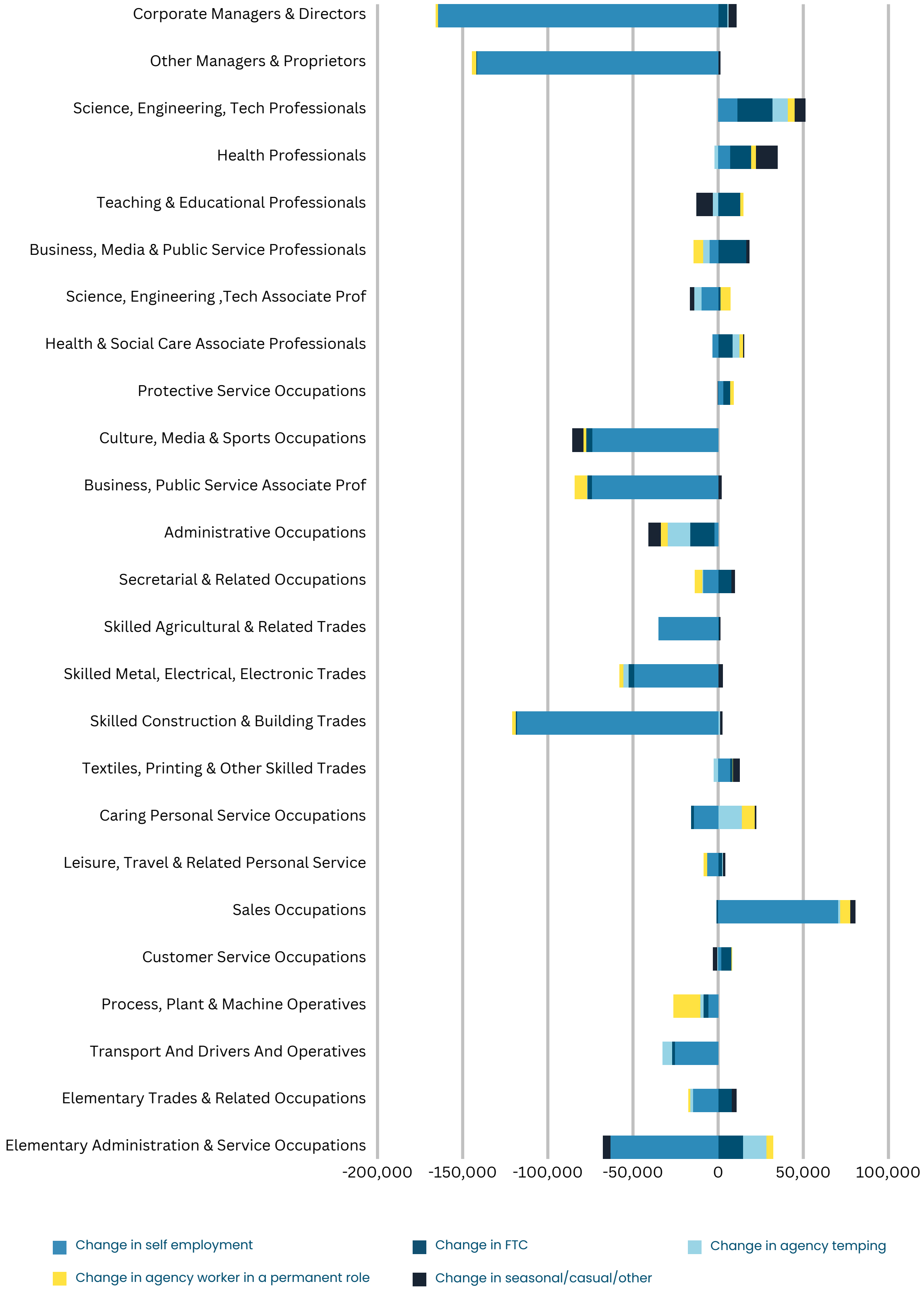
Figure 19. All enterprises, by industry: contingent labour movements, 2019-23



Source: PayePass analysis of ONS Annual Population Survey data

Section Three

How has the umbrella sector fared?

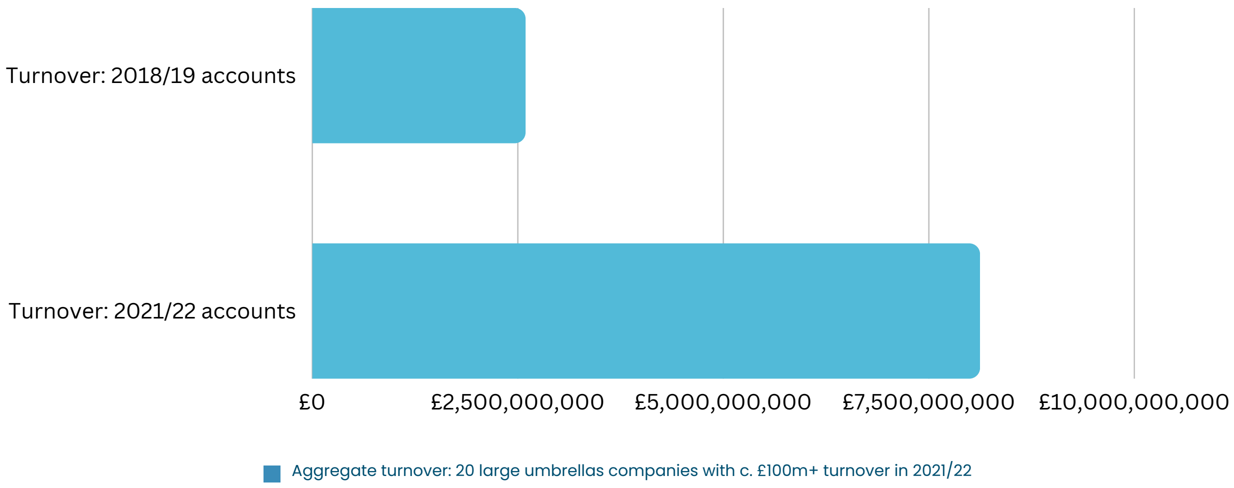
In addition to using official data to chart the likely impact of legislative reforms on worker engagement status, the audited accounts of umbrella companies provide a useful window into activity levels – notably within the largest operators.

As such, we studied the accounts of all umbrella companies with c.£100m+ turnover in 2021/22 and – for those companies where we believed that the data was sufficiently transparent (20) - compared their figures with those published for 2018/19.

Turnover

Across the twenty companies studied, turnover rose by 214%, between 2018/19 and 2021/22, to £8.1bn. Far from this increased activity being an exclusive consequence of a spike in umbrella worker numbers within the market, the larger players' size, scale and strong preferred supplier list (PSL) positioning (which significantly increased to theoretically aid compliance with off-payroll reforms) will likely have resulted in these companies taking umbrella employees away from smaller companies. We expect that 2021/22 accounts show the peak period in change activity, however, after which we believe – as evidenced above – that demand for umbrella working plateaued, or even started to decline.

Figure 20. The aggregate turnover of 20 large umbrella companies, 2018/19 and 2021/22



Source: PayePass analysis of audited / published company accounts

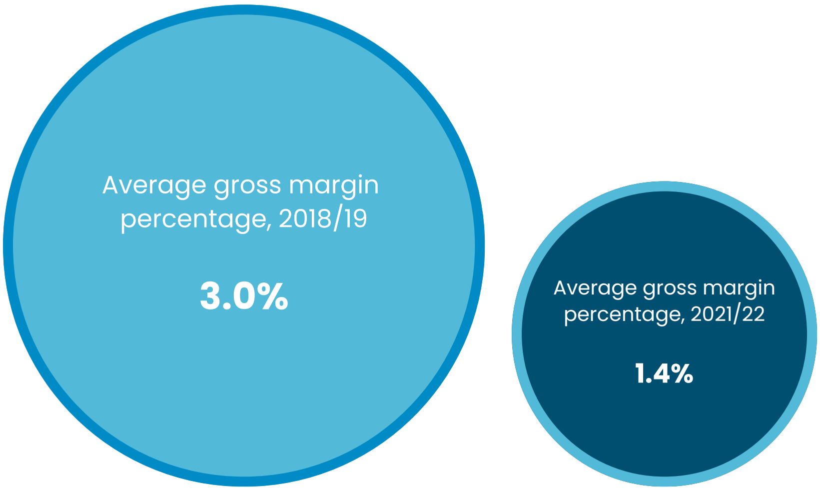
Gross profit margin

Whilst turnover rose sharply over the period, the gross profit margin of these twenty companies significantly decreased, from 3% in 2018/19 to 1.4% in 2021/22. Set in the context of the gross profit of recruitment agencies / businesses, on average around 20%,[7] the umbrella sector is operating on very low margins – and has had to reduce them to secure market share. It is worth bearing in mind that this low margin must cover all umbrella company costs and overheads, including the financial incentives paid to agencies – all of which, once deducted, leaves a tiny proportion as profit. **It is difficult to see how compliant umbrellas can operate sustainably on such low margins.**

As the sector is not paid by hirers nor agencies for its services, however – an unusual scenario in the world of outsourcing – the gross margin (£115m, in the case of these 20 companies in 2021/22) is derived, in effect, from the gross funds (assignment rate) paid to the umbrella company.

[7] https://www.simplicityinbusiness.co.uk/margin-index-report/

Figure 21. The aggregate gross profit percentage of 20 large umbrella companies, 2018/19 and 2021/22



Source: PayePass analysis of audited / published company accounts

Number of umbrella workers

Between 2018/19 and 2021/22, the cumulative number of umbrella workers (reported as 'operations staff', 'flexible workers', non-corporate 'staff', etc.) contained within the audited accounts of these 20 large firms **rose by 39k (64%) to 101k.** From this insight – knowing that the large will have taken away from smaller firms and that umbrella employee numbers reduced within sectors with overall workforce decline - we would conservatively estimate a net gain of c. 100k within the total umbrella worker pool between 2018/19 and 2021/22. **On this basis, we conservatively estimate that the total number of umbrella workers in the UK was at least 700k in 2021/22.**

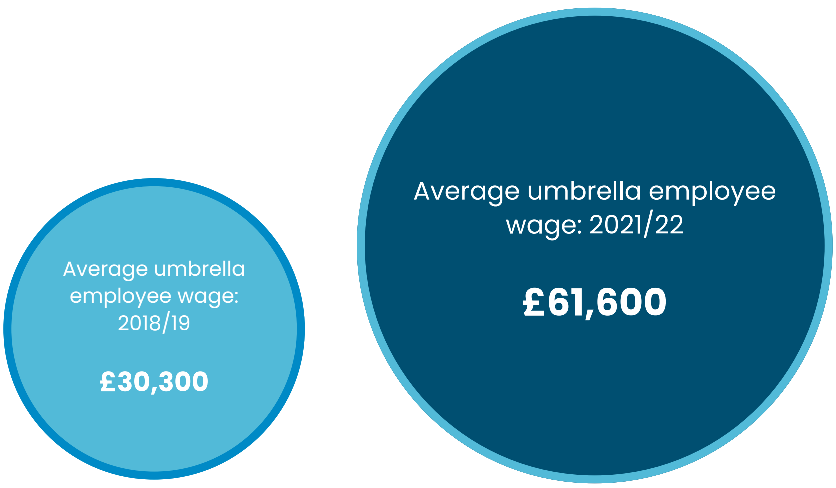
Average Wage per Umbrella Worker

Between 2018/19 and 2021/22, the average wage of umbrella employees reported within the published accounts of these 20 large firms more than doubled to £61,600.

This change is of notable significance, as the profile of the umbrella worker pool has fundamentally changed and now clearly captures higher wage workers - many of whom previously worked through their personal service company, and so were used to paying Corporation Tax on profits rather than PAYE and NICs on gross earnings.

In addition to the significantly increased responsibility to calculate and pay over the correct (and higher value amount) taxes due, there is another key differentiation of the newly enlarged umbrella employee pool which cannot be overlooked. In 2023, we now have two cohorts of umbrella workers who potentially need or want to maximise take-home pay: those at the bottom end of the pay spectrum, most notably impacted by the cost-of-living crisis; and high earners who are used to retaining more of their gross pay.

Figure 22. The aggregate average umbrella employee wage reported by 20 large umbrella companies, 2018/19 and 2021/22



Potential tax take

For our potential tax take and pension fund accrual calculations, we have conservatively estimated an increase in the total number of umbrella employees from circa 600k[8] in 2018/19 to 700k in 2021/22.

We have also run period-on-period Income Tax comparators conservatively based on a flat 20% rate,[8] after the tax-free allowance, on the average wage. On this basis, HMRC should have expected to have received at least an additional £4.7bn in income tax deductions from the sector employing the newly enlarged pool in 2021/22– a 221% rise (to £6.9bn) on our conservative estimate of the figure that HMRC should have received in 2018/19.

Whilst HMRC will have to net off this potential gain with the loss of Corporation Tax payments previously paid over by PSCs, this shows a conservative view on the impact of our estimated 100k additional umbrella workers having income tax deducted via PAYE by their new employers.

Figure 23a Additional estimated income tax payments due to HMRC, 2021/22:

Additional estimated Income Tax payments due to HMRC via umbrella employment, 2021/22 (vs 2018/19):

£4.7bn

Similarly, when considering National Insurance payments, HMRC should have been a net beneficiary of a c. £3.0bn (161%) increase (to £4.9bn) in pay packet-on pay packet payments as a result of an estimated 100k rise in the number of umbrella workers – albeit there is the same offset calculation required to determine the net impact as a result of fewer PSC payments.

Figure 23b Additional estimated national insurance payments due to HMRC, 2021/22:

Additional estimated National Insurance due to HMRC via umbrella employment, 2021/22 (vs 2018/19):

£3.0bn

Lastly, an additional **£1.2bn (719%) in pension fund accruals** should have been paid over to fund providers as a consequence of the increased umbrella worker pool. This sharp increase is likely due to a keenness for former PSC contractors to be efficient with their income.

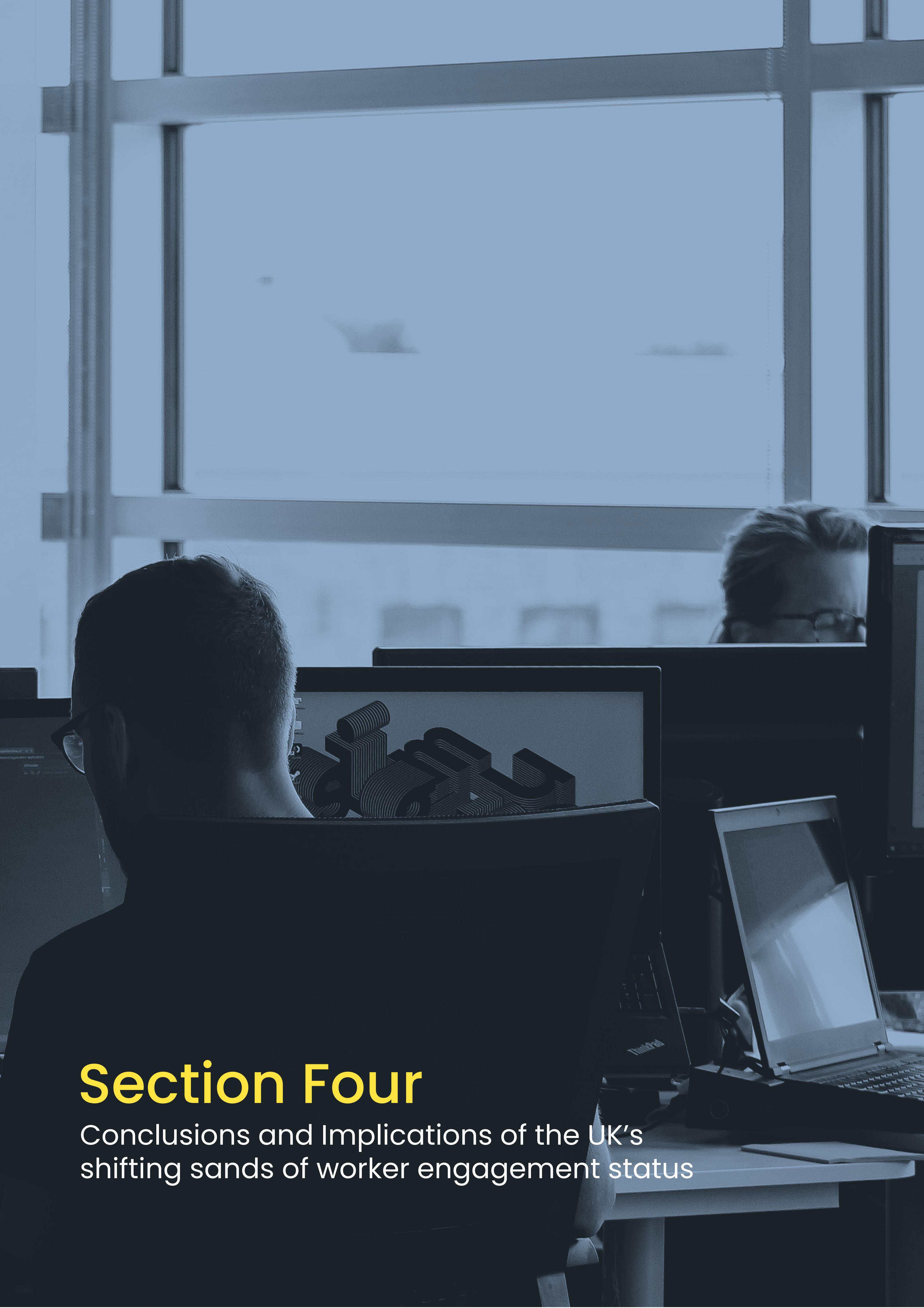
[8] www.litrg.org.uk/sites/default/files/files/LITRG-Labour-Market-Intermediaries-Report-2021.pdf

Figure 23c Additional estimated pension fund accruals due via umbrellas, 2021/22:

Additional estimated
Pension Fund accruals via
umbrella employment,
2021/22
(vs 2018/19):

£1.2bn

With the increasing concentration of umbrella workers into fewer, larger company hands, the UK government should also be a key beneficiary of the reforms - notably through their collection of a larger proportion of the overall tax take due (both due to increased numbers and their capture of significant proportions of higher-paid legacy PSC contractors).



Section Four

Conclusions and Implications of the UK's shifting sands of worker engagement status

1. The net surge in umbrella numbers, as a result of off-payroll legislative change, was not as large as the 'noise' suggested. Moreover, we believe that it has passed its peak.

- For all the noise in relation to PSC contractors being driven into umbrella working, it is clear that many of the gains amongst workers in this engagement status have been offset by losses within industries where the overall workforce size has diminished.
- Following the notably high number of workers who changed their engagement status whilst working in the same job, around the aborted and actual off-payroll reform periods, it is clear that many subsequently sought to move away from umbrella working, notably into a fixed-term contract and permanent employment or out of the workforce completely.
- With a resurgence in self-employment underway – and temporary employment plateauing - it is clear that umbrella working has passed its peak and is likely in the decline.
- If, as the evidence suggests, the rise in umbrella working has now peaked, savvy umbrella companies will focus their strategy on how best to retain their workers and minimise churn.

2. Employers in the north appear to have embraced umbrella working in response to legislative reforms more than employers in the south, where the adoption of fixed-term contract working was prevalent.

- This suggests that north-based employers either did not want to engage workers themselves or did not feel confident in doing so on a fixed-term basis – preferring instead to keep workers at arms-length via umbrella companies.

3. There also appears to have been high levels of umbrella working adoption in sectors and occupations where it was not previously prevalent – notably within the care sector.

- This raises concerns that umbrella working has extended into another low wage sector and that the current cost-of-living crisis may leave workers – here and elsewhere - vulnerable to scheme providers.

4. There were notable differences in the patterns of behaviour amongst former PSC contractors based on whether or not they were able to enact personal choice. The surge in retirement around the time of the off-payroll working reforms in 2021, suggests that umbrella working was not an acceptable alternative to workers who had choice. As a consequence, UK plc. will have lost access to scarce skills that it could not afford to lose.

5. With the swell in umbrella worker numbers created largely through the transition of higher-paid former PSC workers (with no choice) into this engagement status category, the pool of workers seeking to optimise their take-home pay has increased - and fundamentally altered.

- In 2023, we now have two cohorts of umbrella workers who potentially need or want to maximise take-home pay: those at the bottom end of the pay spectrum most likely impacted by the cost-of-living crisis; and high earners who were used to paying Corporation Tax on profits rather than having statutory employment costs deducted from their gross pay.
- This has heightened the need to ensure compliance within the extended worker's supply chain – and changed the dynamics of the potential for non-compliance.

6. Larger umbrella companies were the key beneficiaries of private sector off-payroll working reforms, likely at the expense of smaller enterprises.

- Whilst many of the larger umbrella companies saw a surge in numbers – likely courtesy of time spent securing positions on Preferred Supplier Agreements and their size/scale (enabling them to absorb significant numbers of workers with ease) - smaller enterprises are likely to have either lost numbers or experienced little by way of change.

7. HMRC should also be a key beneficiary of this concentration of the employment tax collection into the hands of fewer, larger providers.

- £4.7bn in **additional** income tax should have been received by HMRC in 2021/22 (compared to 2018/19)
- £3.0bn in **additional** national insurance contributions should have been received by HMRC in 2021/22 (compared to 2018/19)
- **In combination, that is £7.7bn additional revenue for HMRC in 2021/22.**

It would make sense for a portion of the additional revenue to be earmarked for spending on regulating the umbrella sector, something recommended by the Taylor Review [9] in 2017 and committed to in the government's Good Work Plan[10] published in 2018.

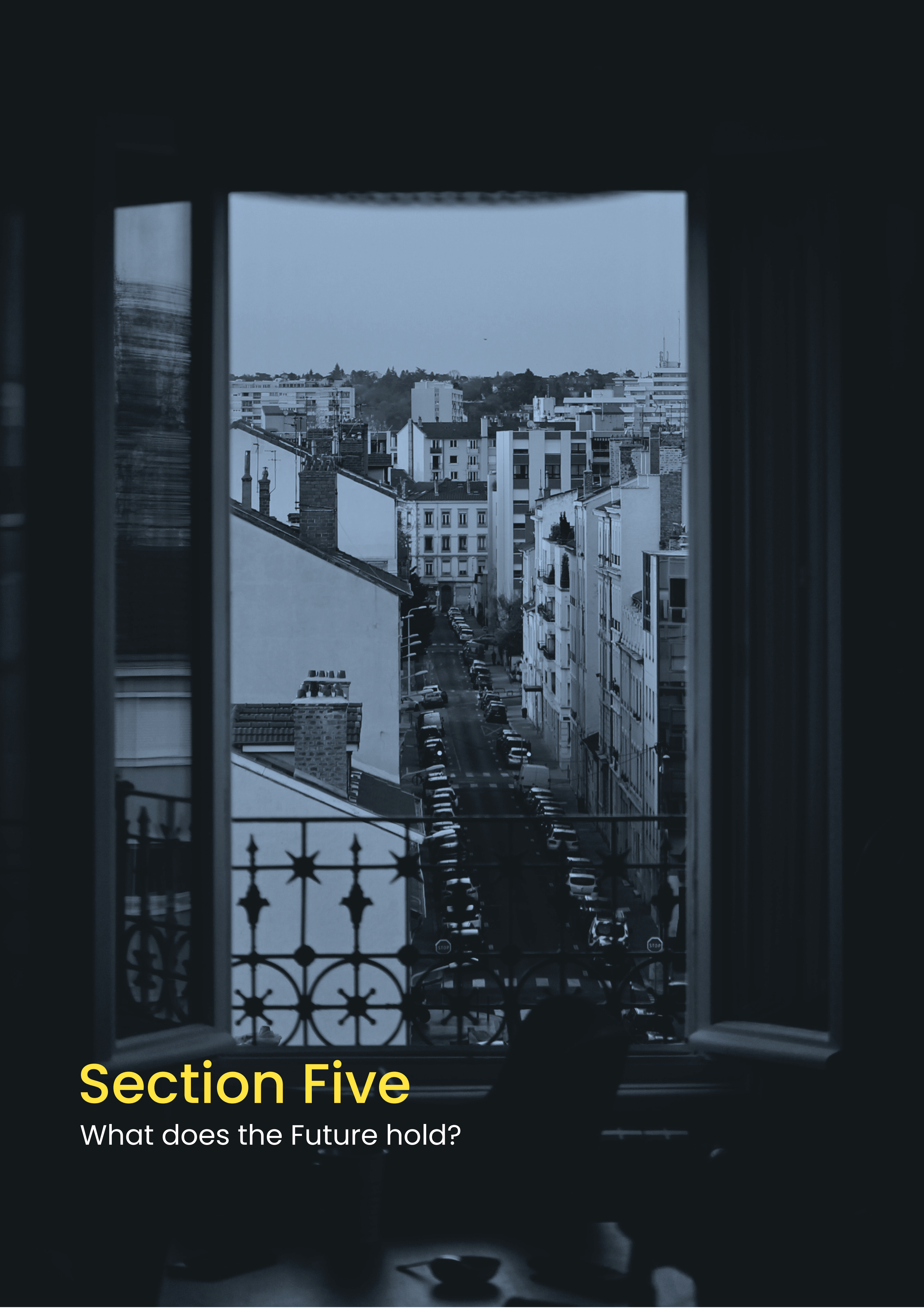
8. The umbrella sector is a key tax collector for HMRC, and our calculations show this was worth approximately £11.8bn in revenue for HMRC in 2021/22.

9. Umbrella company profit margins have halved from 3.0% in 2018/19 to just 1.4% in 2021/22.

It is difficult to see how compliant umbrellas can operate on such low margins, yet recruitment firms require ever-higher financial incentives from umbrellas in order to work with them – this trend is not sustainable.

[9]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf

[10] *Recommendation page 17, page 47,*
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/766167/good-work-plan-command-paper.pdf



Section Five

What does the Future hold?

Perceptions of the umbrella industry

The concept of umbrella working has had a rough ride in recent years, exacerbated by the off-payroll reforms which effectively forced people previously working through their own limited company to work via umbrellas at the behest of their end-client. This lack of choice about how they are engaged has made self-employed people reluctant to work through umbrellas, and their displeasure is subsequently fuelled by the perception that they must pay employers NICs as well as their own PAYE and NICs.

This misunderstanding is exacerbated by two key factors:

1. Off-payroll reforms resulted in previously limited company contractors working via umbrellas, and (despite the legislative detail) the tax and NICs coming from out of the assignment rate which previously would have been paid gross to that contractor.

2. Recruitment businesses mis-advertising rates of pay, deliberately or otherwise, omitting that the assignment rate is not workers' gross pay, but includes all the overheads such as employers' NICs, pension, and umbrella overheads.

Action should be taken against recruitment businesses that deliberately mis-advertise pay rates. A frequent excuse for this poor practice is that their competitor is doing it, so they need to do the same otherwise they will lose business! This is unacceptable on every level, not least because they are deliberately misleading candidates into expecting a higher rate of pay.

Is mistrust of umbrellas just common sense?

It is well known that disguised remuneration tax avoidance schemes masquerade as compliant umbrellas, a fact that tarnishes the reputation of the umbrella sector. In addition, several scandals have hit the umbrella sector in recent years (such as holiday pay misconduct, and systematic skimming of monies) which also add to the general mistrust of the umbrella sector. However these instances are in the minority, and many umbrellas provide a valid, compliant, and professional service to both workers and the recruitment sector.

Notwithstanding, we are aware that reputational problems have resulted in some end-clients banning umbrellas from their supply chain. Some make it difficult for agencies to work with umbrellas by imposing certain rules and regulations so that umbrellas are an unattractive option. Additionally, more parties within the supply chain are now assessing umbrellas' compliance in-house, often resulting in preferred supplier lists of umbrellas that have passed due diligence checks.

But whose choice is it anyway? Whose should it be?

Whilst we understand the need for preferred supplier lists the balance of power is now too far in the hands of recruitment agencies which is being abused in some instances. We regularly hear of workers required to move umbrella at the behest of a recruitment agency, purely because the new umbrella offers a higher financial incentive to the agency. This is unethical because it is detrimental to workers' statutory rights, access to finance (such as mortgages and loans), and pension contributions. It is also detrimental to workers' freedom of choice, which could be argued as unethical because it is toying with peoples' livelihoods.

We urgently need a culture change to bring more choice to workers and stop corruptive practices, which is why we believe that workers should be able to use any umbrella that can prove it is compliant.

What is driving the growth of the umbrella sector?

Without a doubt the various iterations of off-payroll legislation have been a key driving force behind the growth of the umbrella sector in recent years, effectively forcing people who were previously working for themselves into a payrolled arrangement. When examining trends and dynamics within the umbrella sector itself, our analysis clearly shows that a minority of large umbrella companies were best placed to react to the off-payroll legislation by being able to absorb large volumes of workers at scale.

By virtue of their size and stature, this same group of umbrella companies were able to pay significant commission to recruitment agencies in exchange for the business. The omnipresence of commissions makes it difficult for smaller umbrella companies to compete with larger businesses because they simply do not have the financial bandwidth to be able to do so. Some businesses choose to accept loss-making contracts with recruitment agencies which they hope will buy them loyalty and future profits, but this is a risky gamble.

It is clear to us that the financial incentivisation of recruitment companies to recommend umbrellas is spiralling out of control, and is simply not sustainable for compliant umbrellas.

Ever-decreasing umbrella margins

Despite the context of buying-in business from recruitment agencies (by paying commissions), we have seen umbrellas' gross profits slashed by half in recent years; decreasing from 3% in 2018/19 to just 1.4% in 2021/22. Alongside this, we have noticed an increase in the number of umbrellas that are outsourcing some of their own functions, such as payroll, to external providers.

The trend started a few years ago and is an interesting development given that umbrellas themselves provide outsourced functions to recruitment agencies. Presumably this outsourcing enables umbrellas to be ever more efficient, and the savings enable them to afford the requisite financial incentives payable to recruitment agencies.

Increasingly urgent need for regulation

As the umbrella sector is now responsible for some 700k umbrella workers, and £11.8bn in tax and NICs (2021/22), it is increasingly important for the government to regulate the sector. This is particularly important in the context of the disguised remuneration tax avoidance schemes that prey on temps and contractors, a problem that the government has long been aware of, yet completely failed to tackle. Fortunately, it is now perfectly possible to irrefutably prove the tax compliance of any umbrella that a worker/agency/client might want to work with, so there is no excuse for dubious schemes to continue unchallenged within the market.

The growth of the umbrella sector should have resulted in significant additional income being received by HMRC (£7.7bn in total in 2021/22), so we strongly recommend that a portion of this be set aside for regulating the sector. Given HMRC's acknowledgement [11] that most marketed tax schemes target contractors, combined with the recent growth of umbrella working, government-controlled regulation of the sector is now critical.

On which note, a consultation [12] has recently been issued that outlines proposals for tackling non-compliance in the umbrella sector. Options under discussion include a requirement for the supply chain to conduct robust due diligence on the umbrellas that they work with, and debt transfer which would make recruitment agencies (and potentially end-hirers) liable for unpaid tax and NICs in the event that an umbrella goes into liquidation. There is precedent for similar debt transfer in other legislation, so it is almost inevitable to be introduced here as well.

Whilst the consultation is a very positive move, it won't be a quick fix because the legislative process takes time. Whatever the shape of regulation to come, we cannot afford to wait and allow poor practices from seeming compliant umbrellas to continue unchallenged.

Final word

It is clear that the umbrella industry needs to do better and up its game otherwise there is a very real risk that there will be a decision to wipe it out entirely. However, simply paying lip service to raising standards and being compliant is no longer enough, it needs to be proven. This is now in everyone's interest – otherwise, continued false claims of compliance will exacerbate mistrust of the umbrella sector and ultimately could bring about its demise.

[11] https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk-2020-to-2021

[12] https://www.gov.uk/government/consultations/tackling-non-compliance-in-the-umbrella-company-market

About PayePass

About PayePass

PayePass is the ultimate, insured auditing provider specialising in verifying Umbrella Company PAYE compliance, vital for your business and the integrity of the whole supply chain.

PayePass combines market-leading technology with eyes-on auditing by experienced payroll and regulated compliance professionals, ensuring that any incorrect or unlawful payroll activity, whether human error or otherwise, is always identified.

This level of detail is simply not undertaken by other compliance organisations or accreditations. We forensically audit the entire financial trail, transaction by transaction, quickly and efficiently.

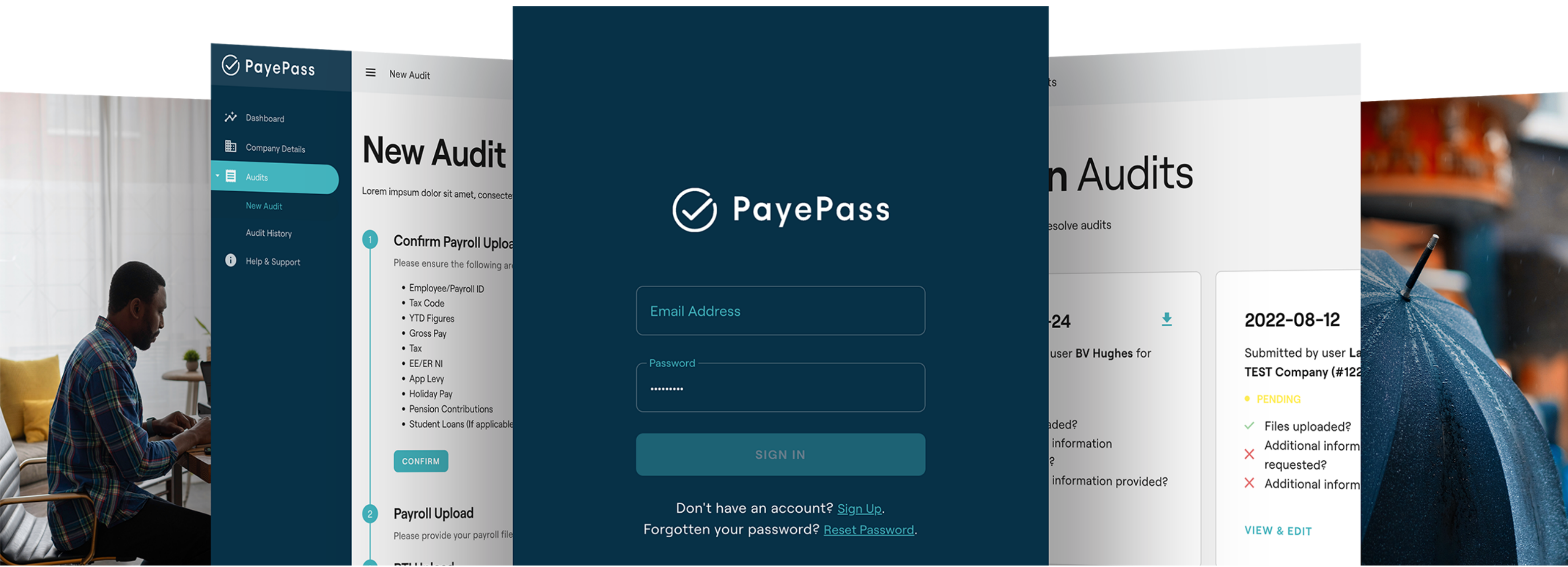
PayePass Verify Award

To qualify for a PayePass Verify Award an Umbrella has to demonstrate complete transparency. Umbrella Companies provide their entire quarterly audit trail, enabling us to ensure that all financial transactions are identified and traced from source, all the way through to the candidate payment.

Comprehensive audits are conducted quickly and with minimal intervention required. Agencies and End Clients can be assured that during the audit process, the following items are checked and cross-referenced against each other to ensure full PAYE tax compliance, removing any risk of future liability.

- All PAYE Payroll Data - inclusive of employee invoices and payslips.
- Evidence of the correct holiday pay treatment.
- RTI Reports and VAT Returns.
- Bank Statements - demonstrating inbound and outbound transactions.
- Proof of Employee Deductions - inclusive of, but not limited to, AEO, SL1, HMCTS.
- Evidence of correct Expense Claims.
- Workplace Pension contribution submissions.
- Employee Statutory Payments.

When an umbrella company displays a PayePass Verify Award, it's a guarantee that our internal team of lawyers, accountants and payroll experts have verified that it has correctly calculated every salary and paid HMRC exactly what is due to it.



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