

[Response to the technical consultation on draft legislation in the Finance Bill 2025-26 re Umbrella Companies: tackling non-compliance in the umbrella company market](#)

[15th September 2025](#)

About ARC

The Association of Recruitment Consultancies (ARC) is a membership organisation for recruitment businesses. Our members are employers as well as providers of introduction and supply services to other employers and hirers, in both the public and private sector. Many of our members utilise the services of umbrella companies as part of their supply services.

This response has been drafted by ARC recruitment specialist lawyers with over 50 years of experience advising businesses in the recruitment sector on all relevant aspects of the law including agency related tax and IR35.

Executive Summary

This response addresses key issues arising from the draft legislation and looks at (a) whether the legislation meets the policy objectives, (b) considers the potential consequences if the legislation is enacted as drafted and (c) considers potential alternatives to the approach including the definition of an umbrella company.

It is our conclusion that the draft legislation **does not meet** the policy objectives and is likely to cause **significant damage** to temporary hiring in the UK if enacted. This conclusion is largely based on the proposed definition of an umbrella company. It is also our conclusion that there are optional **alternative approaches** which would meet the objectives.

The main issues identified are as follows

- Definition of umbrella company is too wide bringing in scope agencies that employ workers
- Umbrella companies can avoid being in scope by engaging workers other than as employees
- Hiring clients may shift behaviour choosing to work only with the largest agencies, skewing the market and reducing flexibility and growth
- Loss of employment rights for workers which may disproportionately affect women
- Nothing to address fraudulent activity in the sector.
- Agencies will have potential tax liability for amounts that they have in good faith already paid to an umbrella, effectively incurring double liability
- Workers may still face tax bills if working with non-compliant umbrellas
- Creates an amount of uncertainty for businesses, punishing the innocent as well as the culpable
- Business will face increased costs, and introduces future and unknowable potential liability
- Strict liability, with no clear right of defence, creates unfairness

- If implemented, the legislation must include a warning system of umbrella default, evidence of taxes being sought from the umbrella, early access to information regarding the taxes due and calculations, available defences, timescales and processes for defence and a reduction in liability where reasonable care has been used.
- An umbrella registration scheme would meet the Governments' stated objectives without incurring the damage to the sector that may be caused by this proposed legislation

Does the legislation meet the policy objectives?

The legislation extends joint and several liability ('JSL') to various parties based on the objectives, who is to be affected, and the key definition of an Umbrella Company, as follows:

(a) The Objectives as set out

This policy has three main objectives:

- *to close the tax gap by protecting taxpayers and the Exchequer from significant losses caused by the fraudulent activities of some umbrella companies — this will also reduce the large sums of money going to organised criminal gangs involved in labour supply chain fraud*
- *to prevent workers facing large, unexpected bills for Income Tax and NIC that have not been paid to HMRC by non-compliant umbrella companies*
- *to ensure that the temporary labour market operates on a level playing field by preventing fraudulent operators under-cutting the compliant businesses that operate within the rules*

(b) Affected persons

The policy document identifies "Who will be affected" as follows:

- *End client organisations that use workers who are engaged by umbrella companies where there is no agency in the labour supply chain.*
- *Umbrella companies that process pay for workers on behalf of agencies and end clients.*

(c) Umbrella company definition

The draft legislation defines an umbrella company ('the key definition') as follows:

- "s.61Y (1)(b) *the worker is employed by a third person ("the umbrella company") —*
- (i) *who carries on a business (whether or not with a view to profit and whether or not in conjunction with any other business) of supplying labour, ..."*

It is understood that the policy intention is in fact that JSL should be extended wherever an actual umbrella company is involved in the labour supply chain, whether or not there is an agency in the supply chain. Agencies are then to be subject to JSL if there is an agency in the chain, the client to be subject to JSL if otherwise.

The key definition is problematic not only as it does not capture actual umbrella companies that operate in the labour supply chain but it also includes businesses that are patently not actual umbrella companies. There appears to be a misunderstanding of what constitutes an umbrella company.

Actual umbrella companies

The distinction between an actual umbrella company and an agency, since both can employ and supply their workers, is that an agency locates/searches for and supplies workers to clients whereas umbrellas do not. This distinction is not reflected in the key definition.

Whilst actual umbrella companies may employ workers they also may engage them using other forms of contract such as contracts for services. Some 'umbrella' companies operate under the Construction Industry Scheme, engaging self-employed CIS registered workers. There is no recognition of these different non employer types of umbrella company at all in the draft legislation.

The confusion of what is an umbrella and its function is further borne out by the statement that umbrella companies *"process pay for workers on behalf of agencies and end clients"*. Whilst a technical point, this is incorrect. Umbrella companies are employers or engagers in their own right and are not agents (*paying on behalf of*) of agencies or end clients.

Consequences and issues

If the current approach is adopted clients of agencies that actually employ (as defined in S.4 of the Income Tax (earnings and pensions) Act 2003 ('ITEPA')) their workers (e.g. Manpower and some ARC members) will be subject to JSL in respect of PAYE and NICs of those agencies even though no actual umbrella company is involved. This is not understood to be the intention of the legislation, and it will cause confusion and risk for clients of such agencies with other potential consequences on the use of agencies as a whole.

To the extent that clients decide to continue working with such agencies, their attitude to risk may likely result in use of only the largest of agencies (seen as unlikely to fail to meet their PAYE and NIC obligations), and /or force them to stop employing their agency workers.

The resultant skewing of the market has not been addressed properly, or at all, and there are no safeguards against these potential outcomes (a) pushing business to larger agencies at the cost of smaller businesses so reducing flexibility and giving unfair advantage, (b) loss of employment (although this is touched upon in the documents as a potential result) and in particular loss of full employment rights which will disproportionately affect women.

The outcome therefore in this regard **does not meet the objective**.

If the intention is, as we believe it to be, to capture all actual umbrella companies and subject agencies and end clients working with such umbrellas to JSL, in our view the legislation will not capture all actual umbrella companies. It will enable some umbrella companies so minded to use other forms of contract in order to present themselves as posing no tax risk to agencies or end clients as the case may be. This would particularly be the case where umbrella companies engage directly with hirers, in which case, if the umbrella company simply varied its model to engage workers under contracts for services, such arrangements would then be completely out of scope of this legislation. **This defeats the objective of this legislation.**

It is accepted that the legislation will result in agencies, that are involved in the labour supply chain and who use umbrella companies, being subject to JSL. However, this outcome is also confused and conflicted as these agencies are not mentioned in the policy document 'who will be affected' which limits parties affected to those where there is '*no agency in the labour supply chain*'. There appears to have been **no assessment of such agencies** in any of the documents leading to this draft legislation.

Loss of employment

Agencies who employ their agency workers may decide, and indeed may be pressured by their clients, to cease employing and instead engage workers on contract for services. This will enable those agencies to cease exposing their clients to potential JSL. Consequently this achieves no advantage to the Treasury whatsoever and seems to be a pointless exercise which simply costs those workers their employment rights. This is particularly oppressive and inappropriate given that these agencies will not be working with actual umbrella companies as regards their employed workers because they are the employer, no actual umbrella company will have been involved in the first place.

At the same time those agencies wishing to avoid JSL may stop working with umbrella companies altogether so resulting in loss of employment not only for the agency workers who were previously up to that point employed by the umbrella companies but also the agency workers who may have been employed by umbrella companies in the future. This is likely to be a significant negative outcome.

Loss of employment rights can have a **particular impact on women** who otherwise would have the benefit of all maternity related rights, which we discuss further in this response.

Additional points

1. Objectives

The legislation goes far beyond the stated intention and specified objectives as follows:

Objective 1. To close the tax gap caused by fraudulent activities of some umbrella companies

- a. The measure will affect the business of all umbrella companies not just those that operate fraudulently. This is accepted in the stated impact on business. The measure will also affect innocent umbrellas that simply make mistakes. In all circumstances JSL will apply, so extending the reach of the legislation well beyond the stated target of the tax gap arising from fraudulent activity. This is patently unfair.
- b. The proposed draft legislation simply creates a lengthier list of those who may be liable rather than addressing the fraudulent activity. It fails to address the key point raised in the policy document *“the ease with which new umbrella companies can be created means that the individuals behind these non-compliant structures can quickly establish new ones and attempt to relaunch them into the umbrella company market.”* There is nothing to stop unscrupulous umbrellas or agencies from doing exactly the same thing, so not achieving any benefit for the Treasury.
- c. There are already criminal sanctions in place for fraudulent activity, including conspiracy to commit fraud. It is patently wrong for an innocent third party to be liable for the criminal actions of a fraudulent operator.
- d. Agencies that are pursued under the proposed JSL provisions will already have paid amounts equivalent to the PAYE and NICs to the defaulting umbrella. A JSL claim will therefore amount to a demand for the same payment again, forcing the agency to make a double payment of the amount. Not only is this patently unfair, but the agency is unlikely to have the funds to meet the claim. This therefore not only poses the likelihood that HMRC will still not recover the money but it may also force the agency to cease trading with consequent loss of employment for all concerned and a loss of tax revenue for the Treasury.

For the above reasons it is not clear how the planned legislation will close the tax gap.

Objective 2. To prevent workers facing large bills

- a. The legislation does not exclude workers from liability and so does not prevent workers from facing large bills from HMRC. Workers are currently liable under various provisions including the Taxes Management Act, ITEPA, and PAYE regulations. This would apply also if the agency is unable to meet a JSL demand. The provisions therefore merely add another party to the liability list and the objective is not therefore achieved.

- b. To the extent that the legislation operates to preclude the use of certain umbrella companies, workers will be prevented from facing large bills. However, the clear stated aim of the policy is to encourage 'increased due diligence' among businesses that use umbrella companies, rather than cease to use umbrella companies. Therefore, the prevention will only ever affect the workers engaged by those umbrella companies that are actually precluded.
- c. The consultation indicates that HMRC already uses *"real-time data to quickly identify people who might have entered tax avoidance schemes, writing to those identified within two months to help them to exit the scheme before they build up large tax bills. HMRC also investigates and pursues non-compliant umbrella companies using its enforcement powers"*. If as claimed this system works well, it should already be meeting the stated objective of preventing large and unexpected tax bills for workers, making these further changes entirely disproportionate.

For the above reasons it is clear that the planned legislation will not result in preventing workers from facing large, unexpected bills from HMRC save only to the extent that the legislation renders umbrella companies to risky to work with, which is not the stated potential outcome.

Objective 3. To ensure that the temporary labour market operates on a level playing field by preventing fraudulent operators under cutting compliant businesses.

- a. The measure is disproportionate in that the impact will be on all umbrella companies, save those outside of the definition, as well as the agencies and clients that use them.
- b. The measure will leave those outside the definition to continue as before, so not achieving any related levelling of the playing field.
- c. Whilst the legislation may preclude the use of fraudulent operators it may also preclude the use of operators that are not fraudulent, since the joint and several liability arises even where non fraudulent mistakes are made in the accounting process. As detailed above, joint and several liability is not limited to circumstances where fraudulent activity is involved.
- d. An additional deterrent in the form of tax liability will not stop individuals or businesses that operate fraudulently but will simply impose an administrative burden and risk on innocent operators. The legislation is therefore unnecessary to achieve this objective.
- e. As previously discussed, the legislation is likely to result in the skewing of the labour market, not only in giving advantage to larger agency businesses, but in removing employment rights from those who otherwise would have them.

For the reasons above the objective is not met. There may be a change in the playing field purely for umbrella companies inside the definition, although this outcome is by no means certain, but it will come at the cost of creating an unlevel playing field for everyone else in the labour supply market generally.

2. Rights and impact assessment

There are rights and impact assessment issues which need to be fully considered, as follows:

- a. Whilst it has been recognised that some umbrella employees may transition to limb b workers as a consequence of the proposed changes and will benefit from protections under the Employment Agencies Act and connected Conduct Regulations and the AWR. It should be noted that umbrella employees and other agency employees already have these protections; they will not gain these. They will however lose their additional protections arising from their employment. For example, rights to unfair dismissal protection, redundancy payments, maternity and paternity leave. Therefore, this change of status would have a material and significant impact on workers' rights.
- b. Further, there appears to be no impact assessment carried out on the effect of the loss of rights, the numbers involved, the extent to which this may have detrimental impact. In particular there does not appear to have been any equality impact assessment carried out. If as a result of these changes a substantial number of employees are transferred to limb b engagements this may have a disproportionate effect on women, in particular limb b workers will not have the same maternity protections as employees and have no right to maternity leave. As part of the general public sector equality duties this impact should be assessed; there has been no published evidence that this assessment has been made.
- c. There is no impact assessment on the loss to workers of expenses claims resulting from loss of employment.

3. Impact on businesses, uncertainty, and additional costs

The draft legislation has clear and significant impacts on business, in particular within the recruitment industry, the impacts of which do not appear to have been fully considered.

It is recognised that some impact has been assessed as it states

“This measure is likely to increase customer costs for some of the businesses affected. HMRC is working to understand these costs and the scope of any impacts better and will update at a future fiscal event. The government is committed to keeping additional business burdens to a minimum in respect of this change.” and “This measure is intended to encourage increased due diligence among businesses that choose to use umbrella companies to engage workers, although many employment agencies already undertake significant due diligence on their suppliers. For those businesses that choose to undertake greater due diligence, one-off costs could include

familiarisation with the new legislation and training or upskilling staff to undertake due diligence checks. Continuing costs could include introducing regular due diligence checks. HMRC already has guidance in place to support businesses with labour supply chain due diligence.”

However, there is little recognition of the following:

- a. Because as now drafted a relevant person may be jointly and severally liable irrespective of fault or the level of due diligence undertaken, this creates uncertainty and punishes all including those who seek to operate compliantly.
- b. Agencies will either have to employ their own due diligence operatives, with no recourse to indemnity in the event of negligence or use external due diligence organisations. Currently such external organisations are operators within the umbrella sector who may have a conflict of interest, and who do not offer insurance or protection in the event of negligence.
- c. Businesses which decide to move away from umbrella use will see costly changes in engagement arrangements, including new contracts, systems, advice etc. Businesses which continue to use umbrellas will face potential future unknown and uncontrollable liabilities. A prudent business would therefore need to take this risk into account in its financial planning, potentially retaining funds within the business rather than investing and promoting growth.

4. Strict liability is unfair

The draft legislation appears to take a strict liability position, with no defence or mitigation opportunities to a ‘Relevant Person’.

Further, the policy paper states *“Joint and several liability will allow HMRC to pursue an agency in the first instance for any payroll taxes that a non-compliant umbrella company fails to remit to HMRC on their behalf. The end client will be liable if contracting directly with an umbrella company.”* The clear implication from this statement is that HMRC will pursue the agency first, not the umbrella company. This is patently unfair.

Putting aside the principle that one business should not be liable for the debts of another, in practical terms the agency will have no employee or payment information except for the payment made to the umbrella, whereas the umbrella company will have all the information. This means that even if defence measures were included, the agency would have no information upon which to base any defence, so further compounding the unfairness and prejudice. It is noted that it is planned also to remove the fraudulent document defence at s.61Z1 ITEPA so leaving agencies wholly exposed.

Recommendations regarding the draft legislation

It is recommended therefore that the draft legislation should be amended to clarify the steps that must be taken by HMRC before making a claim based on JSL including:

- a warning system of default by an umbrella noting that HMRC will be the first party to know of any default
- evidence of a tax demand issued to the umbrella company which has not been met
- access for a 'Relevant Person' to detailed information regarding payments, taxation and contributions, sufficient to enable a Relevant Person to review, and potentially defend any JSL demand.

Further there should be a defence to a claim, a time scale and process for defence, and in any event a reduction of debt where the agency has taken reasonable care (noting that this on its own would encourage use due diligence).

In addition, the planned removal of S.44(4)(b) (see also comments below regarding drafting errors relating to this section also), appears to create a further strict liability position for agencies under that section also, by removing the defence of reliance upon information provided by a relevant person as regards remuneration constituting employment income.

An alternative approach

In August 2023, in response to the consultation on “tackling non-compliance in the umbrella company market” ARC submitted its proposal for an alternative approach. ARC continues to recommend this as a complete solution. We believe would meet the stated objectives without the additional consequences and issues outlined above, and without significant additional cost to either the Exchequer or the recruitment industry, nor therefore creating a barrier to investment and growth.

ARC's proposal in summary is for an umbrella registration scheme. The key components of which being as follows:

- Umbrellas who can demonstrate compliance can be included on a register. Demonstration of compliance should be straightforward as RTI information and compliance checks by HMRC are already in progress, and HMRC will be the first party to know of any non-compliance.
- The effort should not be significant when compared with other registration schemes. For example, estimates suggest 500-700 umbrella businesses in the UK, which is significantly less than businesses holding GLAA licences who are required to have a similar registration/licence.
- Conditions for registration could be limited to tax compliance, or extended to require specific engagement models such as employment, and as umbrellas fall within the remit of EAS, include other compliance requirements.
- Costs of the registration process and compliance checks to be met by a fee chargeable to the umbrella

- Agencies who use an umbrella on the register can do so with the certainty that they are subject to compliance checks. There would be one due diligence check for agencies i.e. is the company registered rather than thousands of businesses (it is estimated that there are in excess of 10,000 temporary agencies in the UK) repeating the same checks.
- An umbrella who is under investigation or fails to meet compliance standards would have their registration removed or suspended, creating a significant deterrent in terms of lost revenue. There could even be an optional alert or notification system that agencies could select and pay to join.
- SMEs can continue to use umbrellas rather than operating their own payroll.
- A further element to add to this proposal would be that should an agency choose to use an organisation that is not registered, the joint and several liability provision can apply.

In contrast to the current approach, the registration scheme would meet the key objectives, of closing the tax gap by reducing fraud, preventing workers facing large, unexpected bills and ensuring a level playing field. At the same time offering businesses certainty, assisting with regulation of the sector, and avoiding third parties having liability for fraudulent activity over which they have neither involvement nor control. ARC therefore requests that the viability of such a scheme should be revisited in favour of the current approach.

Technical points

Drafting issue

There appears to be an error in the draft legislation specifically, the proposed s.61Z1 includes subsections (1) to (5), however then appears to continue with subsection (3) to (7). Subsections (3) to (7) appear to address consequential amendments, so are assumed to be intended to be a separate section, however whether this assumption is correct, whether other subsections, such as (1) and (2), or any limiting provisions are included remains unclear, making it impossible to fully determine the impact of the proposed changes. A corrected version should therefore be published with a further window for consultation on the same.

Definition of umbrella

The proposed definition of an umbrella company at s 61Y(1) (b) is a business who employs a worker. It is assumed that this definition is intended only to cover workers who are engaged under a contract of service or otherwise fall under the definition of employment set out at S4 of ITEPA. However, under s44 (3) (a), agency workers as a whole are treated for income tax purposes as holding an employment with the agency. This therefore creates an element of uncertainty as to whether, when read in conjunction with s44, the definition of umbrella company at s61Y could bring into scope all agencies. The legislation should be clarified in this regard.

Conclusion

For the reasons given we believe that approach taken in the draft legislation does not meet the stated objectives and presents practical difficulties for the recruitment industry with potentially damaging consequences for the labour supply market and economy as a whole. We recommend change as set out herein.



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