

Tax relief for travel expenses: temporary workers and overarching employment contracts

July 2008



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CONTENTS

		Page
Chapter 1	Introduction	3
Chapter 2	Forms of temporary work	5
Chapter 3	Tax relief for travel expenses	11
Chapter 4	The use of umbrella companies	15
Chapter 5	Employment agencies and overarching employment contracts	21
Chapter 6	Potential problems with overarching employment contracts	23
Chapter 7	Action to address the problems identified	27
Chapter 8	Consultation process	29
Annex A	Impact Assessment	33

INTRODUCTION

1.1 In recent years the temporary labour market has grown in importance, as employment patterns increasingly move away from the traditional model of long-term, permanent contracts. The Government is aware of the importance of the temporary labour market, and the benefits it can provide both to businesses and to workers.

1.2 Temporary workers are not homogenous and encompass a range of types of workers, work patterns, skills, remuneration levels and underlying contractual arrangements. Clearly the tax rules need to work fairly across this diverse sector. And, where the rules are abused, giving some an unfair advantage, that abuse needs to be addressed.

1.3 This document considers structures which use overarching employment contracts - umbrella companies and employment agencies.¹ These were referred to in paragraph 4.70 of Budget 2008 which stated:

“The Government is concerned at the growing use of structures such as “umbrella companies” or overarching contracts of employment with employment businesses, to obtain tax relief for travel expenses that would not be available to other workers. It will monitor the use of these structures and, if necessary, consider action in the future.”

1.4 The cost of travel between home and work is normally regarded as a personal expense, putting an individual in the position to do his job, rather than an expense incurred in performing his duties. Travel between home and a permanent workplace does not attract, and never has attracted, tax relief, whether the engagement is short or long term, or the worker is engaged on a temporary or permanent basis. However, a distinction is made for temporary workplaces where the worker goes to perform a task of limited duration, or for a temporary purpose. Tax relief is given for travel between home and temporary workplaces, but this depends on the workplace being a temporary one within the rules, not on whether the worker is on a temporary contract.

1.5 By using overarching employment contracts, umbrella companies and some employment agencies are able to change what would be a series of permanent workplaces (for which no tax relief is due for travel between home and work) into temporary workplaces (for which relief is due). Chapter 3 describes the current rules in more detail.

1.6 The Government is particularly concerned at evidence that umbrella companies and employment agencies using overarching employment contracts often abuse the travel expenses rules, by encouraging their workers to claim expenses which were not genuinely incurred or for which no relief is due. When HM Revenue and Customs (HMRC) attempts to claim the tax owed, they may encounter difficulties in recovering the underpaid tax and national insurance contributions (NICs). Umbrella companies, in particular, have few assets and can wind up and move their workers to a new company without paying the tax and NICs due. This failure to comply with the rules leads to losses to the Exchequer and puts compliant businesses at a competitive

¹ For the purposes of this document ‘agency’ or ‘employment agency’ is used to refer to an agency which supplies workers to end clients and remains part of the ongoing relationship between worker and end client (technically known as an employment business). This differs to an introduction agency (known as an employment agency). These terms are defined in the Employment Agencies Act 1973, as amended by the Employment Relations Act 1999.

disadvantage, The Government wishes to consider action to improve levels of compliance. In this area, as with others where there is evidence of significant non-compliance, action will be taken to address this.

1.7 Beyond this, the Government is also concerned to maintain the principle of fairness in the tax system. The current rules mean that the use of overarching contracts allows some temporary workers to obtain tax relief for travel between home and the workplace. It was not the original intention that relief should be given for such journeys and it is unfair that some get tax relief when others working in similar circumstances do not. The Government wishes to consider whether there is a case for continuing to give relief in this way through these sorts of arrangements. In other words, it wishes to weigh up whether or not there are advantages for business and the flexible labour market that outweigh the unfairness and, if not, how to tackle the unfairness.

1.8 There are other potential problems with umbrella companies and employment agencies using overarching employment contracts. Concerns have been raised about the potential exploitation of workers through the use of overarching employment contracts, and the extent to which workers are obliged to work through umbrella companies and employment agencies using these contracts.

1.9 The Government would welcome comments on its analysis of the sector and the labour market in which it operates, in terms of the size of the sector, the role of these structures in the wider labour market and on the problems identified. The Government would also welcome comments on the possible actions to address these problems including the effect they may have. These are set out in Chapter 7. Comments on any alternative approaches would also be welcomed.

1.10 Chapter 8 sets out details of the consultation process. Comments should be submitted by 13 October 2008.

2

FORMS OF TEMPORARY WORK

2.1 The traditional model of long term full-time employment with one employer has become less common in the UK in recent years. As business seeks a flexible and adaptable workforce to be able to respond to new opportunities and maintain competitiveness and workers themselves seek more flexible working arrangements, opportunities for part-time work, fixed-term contracts, multiple employments and agency work have grown. This chapter looks at some of the main forms of temporary work.

AGENCY WORK

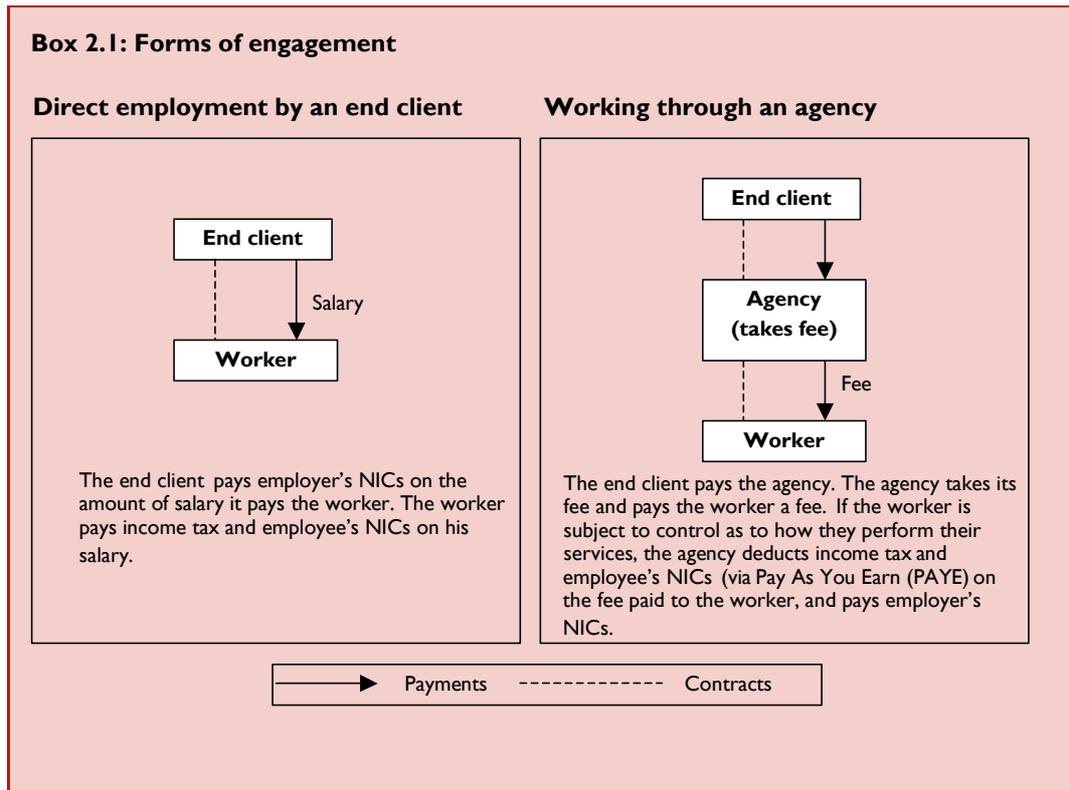
2.2 Agency work is a common choice for many individuals and it is estimated that there are around 1 million agency workers in the UK.¹

2.3 Agency work takes a number of different forms in terms of the nature of the engagement and the type of work performed. Agency workers include both individuals in business on their own account (that is, where the true relationship between the worker and end client is a contract for services) and individuals who are temporary employees (that is, where the true relationship between the worker and end client is a contract of service). An agency worker is not usually engaged as an employee of the agency - more often agency workers are engaged under a contract for services, although it is believed a minority of agencies do offer their workers contracts of employment. Agency contracts allow more flexibility for either party to terminate the contract. This gives the worker flexibility, for example, about when he chooses to work and means the agency does not have to offer any guarantee of the minimum hours of work it will provide. The agency supplies the worker to the end client who needs the worker's services and remains a permanent part of the contractual chain between the parties. The end client pays the agency for the work carried out, the agency deducts its fee from the payment received and pays the worker a fee.

2.4 Although the worker is not an employee of the agency, in many cases, where the worker is subject to control as to how they perform their services, the agency deducts income tax and national insurance contributions (NICs) from the fee paid to the worker. They must also pay employer's NICs on these payments to the worker. This treatment is applied by legislation² which deems such payments to be employment income.

¹ Recruitment and Employment Confederation's Recruitment Industry Census 2006 estimates 1.08 million agency workers in work. There are a number of sources estimating the number of agency workers in the UK and the Department for Business Enterprise and Regulatory Reform is undertaking its own research to verify industry estimates.

² Chapter 7, Part 2, Income Tax (Earnings and Pensions) Act 2003 and Social Security (Categorisation of Earners) Regulations 1978.



Agency overarching contracts of employment

2.5 Sometimes the worker will be engaged under an overarching employment contract with the employment agency. The employment agency's business remains one of matching temporary workers with end clients and it continues to be responsible for finding the work and placing the worker. However, an overarching employment contract means that the worker has an ongoing employment with the agency. As an employee the worker receives a salary and the agency must deduct income tax and NICs from the worker's salary and pay employer's NICs on this amount (regardless of whether or not the worker is subject to control by the end client). This type of arrangement is becoming more and more frequent, and is discussed in more detail in Chapter 5.

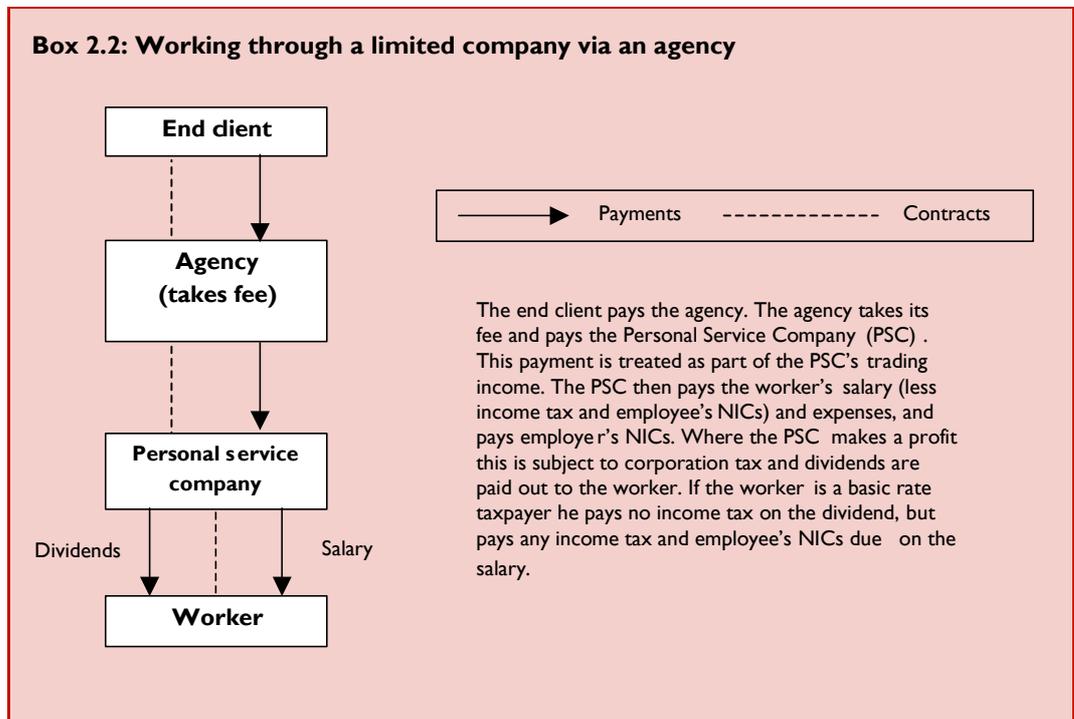
INTERMEDIARY COMPANIES

2.6 There has also been a growing trend for temporary workers, both those in business on their own account and those who are temporary employees, to provide their services through intermediary companies. This may also involve working through an agency. Where this is the case, the agency remains responsible for finding the work and placing the worker, but pays the intermediary company for the worker's services without making any deductions for income tax or NICs. The intermediary company will then pay the worker and will make these deductions on the worker's salary and pay employer's NICs.

2.7 Intermediary structures used by workers to provide their services via agencies, or directly to end-clients, take a number of forms. The three most common are personal service companies (PSCs), managed service companies (MSCs) and umbrella companies.

Personal Service Company

2.8 A worker in business on his own account who sells his services to an end client may choose to set up and run his own limited company (sometimes called a PSC). The worker is usually a director of the company and may draw a salary from the company but, as a shareholder of the company, is also able to receive payment in the form of dividends.



2.9 For workers providing their services this way, the Intermediaries legislation³ (known as “IR35”) may apply. The Intermediaries legislation is designed to prevent workers gaining a tax advantage from working through their own PSC, when the terms of an engagement would normally be considered one of direct employment with the end client. As a simple example, if an IT contractor was working for Company X as an employee, then resigned and was re-engaged to do exactly the same work through his PSC, IR35 may apply in this instance.⁴

2.10 The Intermediaries legislation means that where a worker performs services for an end client through an intermediary in such a way that they would be regarded as an employee if they worked directly for the client, the intermediary company (the PSC) has to treat the income the company receives from the end client for that engagement as employment income. It must therefore deduct income tax and NICs on that income.

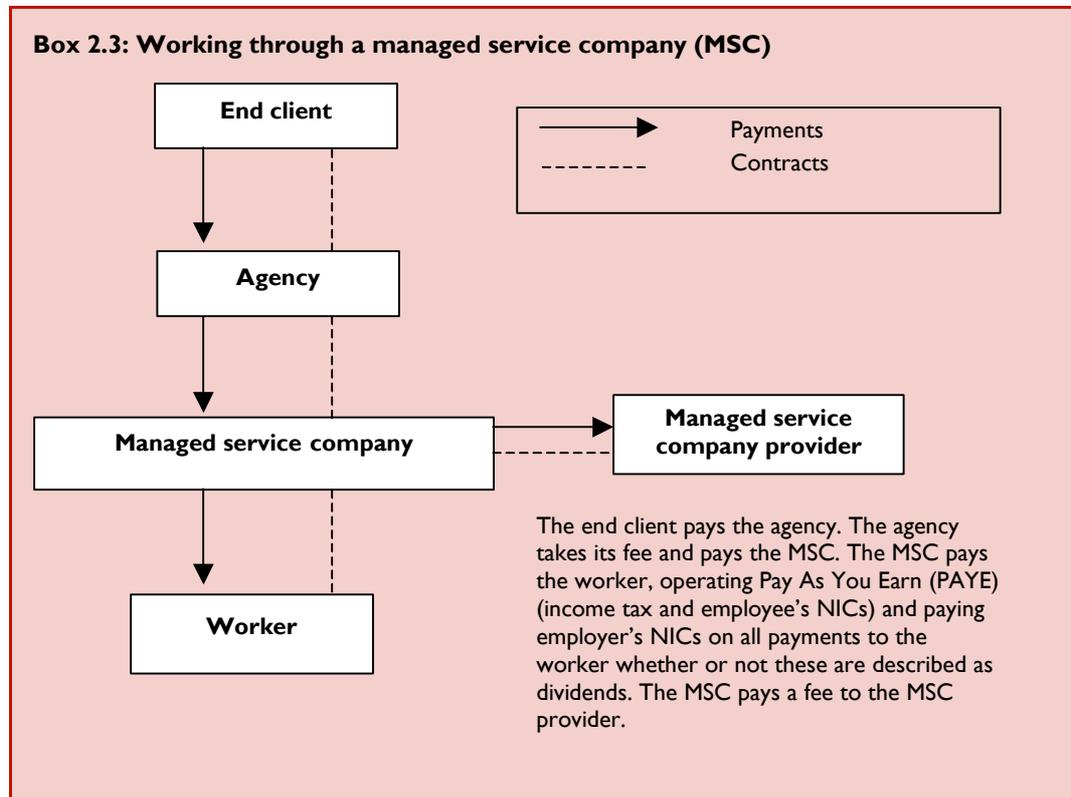
Managed Service Company

2.11 A worker may provide his services through an intermediary company where the arrangement is in many respects similar to a PSC. The worker is a shareholder in the company and may be a director. However, in an MSC the worker will not normally be involved with the running of the company, nor ultimately controls it – an MSC provider takes on these roles.

³ Chapter 8, Part 2, Income Tax (Earnings and Pensions) Act 2003.

⁴ Whether IR35 applies would depend upon all the terms and conditions of the engagement with the end client.

2.12 Workers operating through MSCs were almost invariably not in business on their own account, and MSCs were used to avoid paying employed levels of income tax and NICs. The MSC legislation, which was introduced in April 2007,⁵ deems any income earned by a worker through an MSC to be employment income, thus the MSC must deduct income tax and NICs from all payments made to the worker. Since the MSC legislation was introduced, the number of MSCs has decreased substantially.



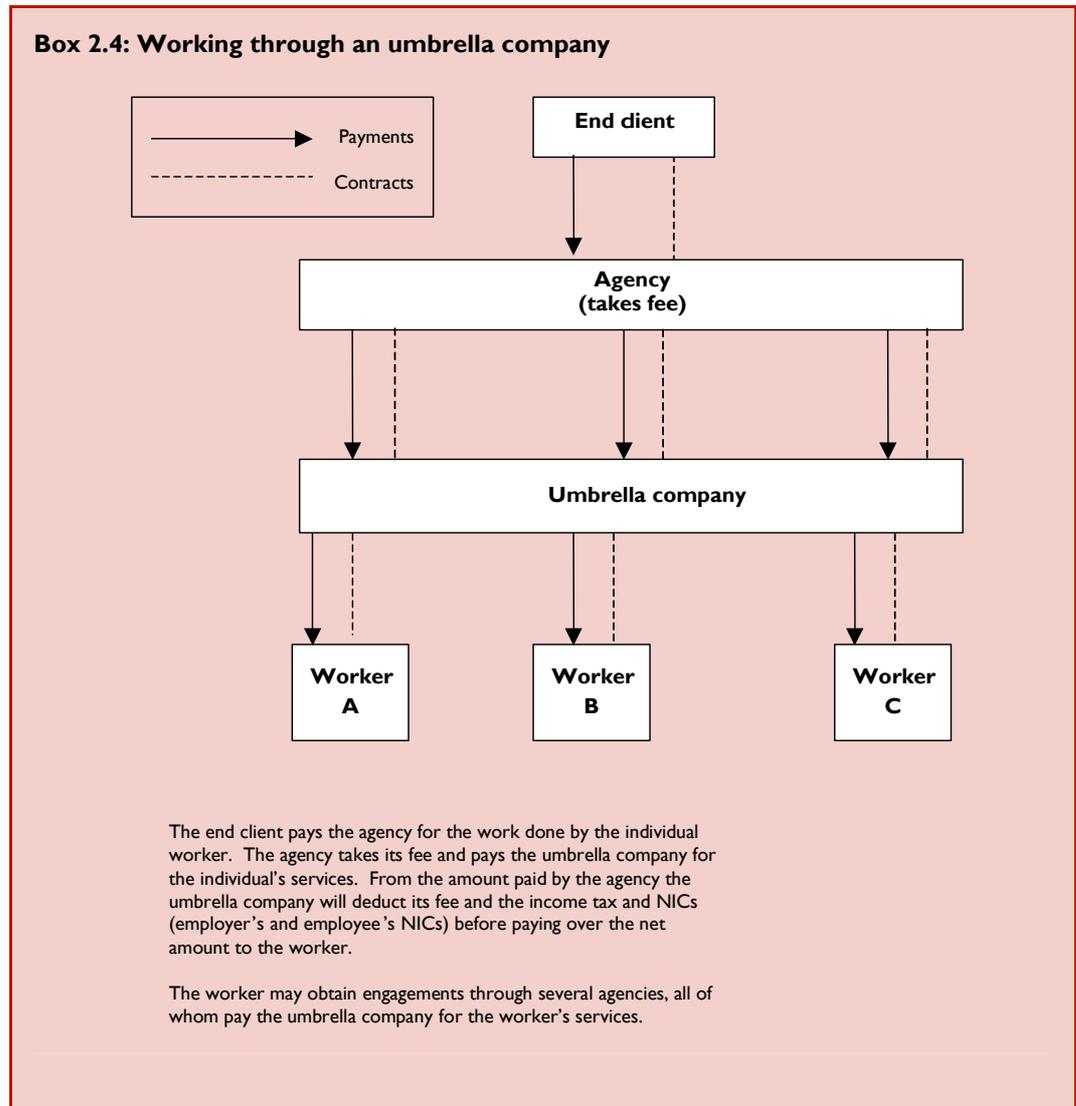
Umbrella company

2.13 In an umbrella company the worker has an overarching employment contract with the company. The worker is not a director, nor does he own any shares in the company. The worker works for end clients but rather than working directly for them, he provides his services through the umbrella company. In some cases the worker sources engagements directly, and in other cases an agency will source engagements. In the latter case the end client pays the agency, which deducts its fee and in turn pays the umbrella company for the worker's services.

2.14 The umbrella company will pay a salary to the worker along with any expenses due and deduct income tax (via Pay As You Earn (PAYE)) and both employee's and employer's NICs. The umbrella company will retain its fee, a weekly or monthly sum (generally not charged when the worker is on holiday or between assignments) and may also retain a regular sum to be paid later as holiday pay. Other deductions might include optional services such as insurance. Anything the umbrella company pays the worker, for example net salary, expenses and holiday pay, as well as any income tax deducted under PAYE and both employee's and employer's NICs is funded out of the gross sum the worker earns since the company does not normally have any other source of income.

⁵ Chapter 9, Part 2, Income Tax (Earnings and Pensions) Act 2003.

2.15 Generally many employees will provide their services through the same umbrella company.



2.16 As can be seen there are a variety of ways in which temporary workers can provide their services, and the workers themselves are not a homogenous group – they range from highly paid, highly skilled IT contractors, to seasonal fruit pickers paid at the National Minimum Wage. Nevertheless, the tax rules need to operate fairly across this diverse sector to ensure as far as possible a level playing field across the temporary labour market.

3

TAX RELIEF FOR TRAVEL EXPENSES

3.1 This chapter explains how the travel expenses rules work, and how overarching employment contracts enable umbrella companies and some agencies to offer their workers this tax relief that is not available to other temporary workers working under different arrangements.

HOW THE RULES WORK

3.2 In the modern labour market many workers no longer work solely at one site, they may travel to work at several different locations. Permanent employees usually have a fixed workplace where they work for the majority of their time, but may also be required to work in other locations from time to time. Temporary workers work in various locations for different engagers or end-clients, often for short periods of time.

3.3 There is no distinction between permanent employees and temporary workers in the income tax and national insurance contributions (NICs) rules for travel expenses; the same rules apply to both.

3.4 As a general rule, tax relief is not given for the cost of travelling between home and the workplace. That is regarded as a personal expense, which puts someone in a position to perform their duties, rather than a cost incurred in the performance of their duties. There is no clear case for giving relief for such journeys except in limited circumstances where the employee is working away from their normal place of work at a temporary workplace.

3.5 Travel expenses include the cost of travel, subsistence (food and drink) and accommodation (where there is an overnight stay). Employees are able to obtain tax relief for travel expenses as follows:

1. Travel expenses incurred “in the performance of the duties” of their employment.
 - For example, employees such as commercial travellers, or service engineers, qualify for relief under the “in the performance of the duties” rule. Unlike most employees, who have a permanent place of work, they are actually employed to travel as part of their duties. For other employees, this rule also enables them to obtain relief for the expenses of travelling from one workplace to another within the same employment – but not between their home and either workplace.
2. Travel expenses to a temporary workplace
 - Workers may receive tax relief on travel expenses to a temporary workplace, but not if the journey counts as ordinary commuting or private travel.
 - This rule generally applies when a worker undertakes an engagement at a workplace other than their usual one. Tax relief is available for any travel expenses incurred on travelling between their home and a temporary workplace. For example, a London-based businessman attending a one-off meeting in Edinburgh would be eligible for relief on travel expenses between his home and Edinburgh.

- It also applies when a worker in continuing employment works at a succession of places for short periods of time.

3.6 An employee cannot have relief for the cost of a journey which is ordinary commuting or private travel.

Travel expenses to a temporary workplace

3.7 The travel expenses rules state that workers are entitled to tax relief for travel between their home and a temporary workplace, but not a permanent workplace. A temporary workplace is somewhere the employee goes only to perform a task of limited duration or for a temporary purpose.

3.8 A workplace is a permanent workplace if the employee:

- goes to the same workplace in the course of a period of continuous work which lasts, or is likely to last, for more than 24 months; or
- goes to the same workplace for all or almost all of the time for which the employee is likely to hold, or continues to hold, the same employment.

3.9 If either of these criteria applies a worker would not be entitled to tax-relief for travel expenses between home and work.

How the rules have changed

3.10 Tax relief for travel which is undertaken as part of an individual's work has been allowed for well over a hundred years. However, in the late 1990s the Government recognised that travel to a temporary workplace presents an additional burden on the worker, and as such tax relief should be given for travel expenses to temporary workplaces (in certain circumstances). The existing rules were therefore changed in 1998 to allow relief for travel to some temporary workplaces. This was a considerable relaxation over the previous position. Prior to 1998 most workers were allowed to claim tax relief for travel only from their usual workplace to a temporary workplace. The new rule allows workers access to tax relief for travel and subsistence expenses for travel between their home and a temporary workplace.

Temporary workers

3.11 Most temporary workers on short-term contracts are not entitled to tax relief for travel expenses between home and work, since they will usually only work at one location during that employment. Travel from home to this location is not eligible for tax relief since it would be considered a permanent (not a temporary) workplace, and is not undertaken "in the performance of the duties" of that engagement.

3.12 Similarly, temporary workers working through an employment agency are not normally entitled to tax relief for travel between home and work. This is because although they may be contracted to work on different engagements through the same employment agency, each engagement is treated as a separate employment for tax purposes, and a temporary worker normally attends only one workplace for all or almost all of that engagement.

3.13 For the vast majority of temporary workers who are employed directly or through an agency, this means they are treated in the same way as permanent employees, who are also not entitled to tax relief for travel between home and work. However, use of an overarching employment contract allows temporary workers access to travel expenses, which would not normally be available to them.

Overarching employment contracts

3.14 An overarching employment contract works by linking a series of separate employments, or agency assignments, into a single, ongoing employment. This changes what would otherwise be a series of permanent workplaces (for which no tax relief is due for travel between home and work) into temporary workplaces (for which relief is due).

3.15 By using an overarching employment contract a worker can often claim tax relief on travel expenses between home and work provided the site he works at has now become a temporary workplace.

Salary Sacrifice

3.16 The use of overarching employment contracts often allows workers to arrange their affairs so that they are entitled to tax relief for travel expenses, but in most cases the travel expenses are not paid on top of the worker's salary. Instead they are paid as part of a salary sacrifice arrangement. Salary sacrifice arrangements enable a worker to "sacrifice" a proportion of their salary, which is instead paid as travel expenses - free of income tax and NICs.

3.17 The worker benefits as he receives a proportion of his money free of the income tax and NICs which would otherwise have been due and in this way increases his take home pay. The worker's employer also benefits since the amount of salary on which it has to pay employer's NICs is reduced. In some cases the employer adjusts the rates it pays to take account of the lower income tax and NICs bill so the employee does not necessarily obtain the full advantage of the relief to which he is entitled.

3.18 Of course, depending on the labour market at the time, employers may pay some or all of the workers' travel expenses on top of their salary, rather than under a salary sacrifice arrangement. If workers are in demand it is more likely that travel expenses will be paid on top of a worker's salary rather than under a salary sacrifice.

Dispensations

3.19 An umbrella company or an employment agency (like other employers) can obtain a dispensation from HM Revenue and Customs (HMRC) that includes an agreement to pay scale rate subsistence allowances to cover the cost of meals that employees buy when they are at a temporary workplace. Subsistence expenses count among travel expenses.

3.20 Often the employer will seek a dispensation for the payments it intends to make. Dispensations are issued in order to reduce administrative burdens on businesses and HMRC. A dispensation is an agreement between HMRC and the employer about what benefits and expenses can be paid to its employees, without them having to be notified to HMRC.

3.21 Any dispensation given to a business by HMRC will set out the circumstances and amounts that can be claimed for that expense without any associated payment being reported. Where the employer can demonstrate the amounts it pays its employees broadly reflect the amounts of allowable expenditure its employees incur, then HMRC will also agree scale rate allowances that can be included within the dispensation. If a dispensation includes such an agreement, this means that the

umbrella company or employment agency can pay the worker's travel and subsistence expenses, without having to report these expenses annually to HMRC on forms P11D.

3.22 Subsistence expenses, which count as travel expenses, are a common example of expenses which employers choose to reimburse by means of a scale rate payment rather than by reimbursing the precise expenditure incurred. For example, instead of requiring a receipt to be kept, an employer may allow a standard amount of £6.50 for breakfast to be claimed.

3.23 HMRC's guidance for staff says that when considering applications, they need to be satisfied that the proposed scale rate payments are set at a level which broadly represents the amount that the employees are actually spending on allowable subsistence expenses. However, in the case of the disparate workforces and working patterns covered by an umbrella company, it may be difficult to arrive at a sensible amount that genuinely represents actual expenditure incurred by employees.

Abuse of dispensations **3.24** Where HMRC believes that a dispensation is being abused (i.e. workers are claiming expenses that were not genuinely incurred) it can withdraw a dispensation. It has also recently tightened up its approach to retrospective withdrawal of a dispensation. Where it is apparent that negligence or misrepresentation has taken place and expenses and benefits were provided under a dispensation when they should have been subject to income tax and NICs, HMRC will pursue retrospectively the income tax and NICs liabilities due when the expenses payments and benefits were originally provided.

4

THE USE OF UMBRELLA COMPANIES

4.1 Umbrella companies have been in existence for some years but their popularity has grown considerably since the managed service company (MSC) legislation was introduced in April 2007. Many umbrella companies are operated by providers who previously operated MSCs and many former MSC workers have moved to umbrella companies. In addition, umbrella companies are attracting new workers. This chapter looks at the different reasons why the umbrella model is adopted.

TAX IMPLICATIONS

4.2 Workers operating through an umbrella company are employees of that company and therefore employed levels of income tax and national insurance contributions (NICs) are deductible from the income paid to the worker. Workers also bear the cost of employer's NICs on their income since the income they generate represents the company's only income.

4.3 However, this structure generally enables the worker to obtain tax relief for the costs of travel between home and workplace which would not ordinarily be due to a temporary worker. The way in which umbrella companies are able to give their workers this relief is described in chapter 3.

4.4 The marketing material of umbrella companies generally highlights the tax advantages available to workers using them (see Box 4.1).

Box 4.1: Advertising by umbrella company about the tax saving

No other umbrella can legally “get you more expenses”. Whilst we encourage the claiming of expenses as a way to tax mitigate earnings, we do so within the ambit of the law.

Source: umbrella company website

OTHER ADVANTAGES

4.5 There are other potential benefits from using an umbrella company which may also be important to temporary workers.

Low cost administration

4.6 Many umbrella companies emphasise in their marketing material the range of administration services provided for a low weekly fee – typically around £20. For some temporary workers this may offer a low cost alternative to running their own companies. This might be true for workers new to contracting who want to focus on securing work and leave the administration to someone else (see Box 4.2).

Box 4.2: Advertising by umbrella company about the service it offers

The “Value Checklist” below demonstrates what you get for a weekly fee of £20:

- Ability to claim tax relief on a wide range of expenses
- No Intermediaries Legislation (IR35) risk
- Professional Indemnity cover -£1m
- Public Liability cover - £2m.
- Employers Liability cover -£25m
- Completion of year end tax returns
- Same day CHAPS payment into your personal account
- SMS text messaging service –Notification of payments

Source: umbrella company website

Low risk

4.7 Workers who are in business on their own account, for whom running their own company is an option, may decide to operate through an umbrella company instead if they are concerned about the possible impact of the MSC legislation.

4.8 There is anecdotal evidence that some workers are concerned that they may find themselves operating a company that is deemed to be an MSC under the MSC legislation. Operating through an umbrella company removes this risk, while offering some of the tax advantages that a service company might bring (see Box 4.3).

4.9 The use of an umbrella company also means that the worker does not need to consider whether the Intermediaries legislation (IR35) applies since the worker is not working through a Personal Service Company (PSC), but rather, is an employee of the umbrella company.

Box 4.3: Advertising by umbrella companies about the low risk

“You will be covered by our insurance, and have the back up of our award winning team. We will also ensure that you are safe from the recent legislation changes and be secure in the knowledge that you will pay the correct amount of tax.”

“How does an umbrella work? We sign a contract with the agency, and you have a separate employment agreement with us. This effectively makes us your employer. Once we have your timesheets and expenses claims, we'll invoice your client/agency, receive the money and then pay you direct. You avoid all the red tape that comes with being a company director. You avoid all the hassle of IR35 and the serious risks of infringing anti-avoidance legislation. You have no fees to pay when you're not working. And you still get tax relief on your expenses. The net result? Less fuss all round.”

Source: *umbrella company websites*

Treatment of workers

4.10 As a permanent employee a worker is entitled to more extensive employment rights than are granted to temporary or agency workers who have greater flexibility over working patterns. Both employees and temporary workers are entitled to core rights including health and safety, paid holiday, National Minimum Wage and social security guarantees such as Statutory Maternity or Statutory Paternity pay. But employees have additional rights such as maternity and paternity leave and redundancy pay.

4.11 Some umbrella companies highlight employment rights as one of the advantages of working through an umbrella company rather than as an agency worker. The individual will have a contract of employment that grants the full employment rights and statutory protections.

4.12 However, the treatment of temporary agency workers in the UK is due to change. On 20 May 2008 the Government, Confederation of British Industry (CBI) and Trade Union Congress (TUC) reached an agreement on how fairer treatment for agency workers in the UK should be promoted while not removing the important flexibility that agency work can offer both engagers and workers. One of the key features of the agreement is that after 12 weeks in a given job an agency worker will be entitled to equal treatment. Equal treatment will be defined to mean at least the basic working and employment conditions (including pay but excluding occupational social security schemes such as pensions) that would apply to the workers concerned if they had been recruited directly by that undertaking to occupy the same job.

4.13 The Government has been engaging with its European partners to seek agreement on the terms of the Agency Workers Directive that will enable this agreement to be brought into legal effect in the UK. A key stage in this process was reached on 9 June when the Council of Ministers reached political agreement. The eventual coverage and scope of the domestic legislation will be considered as part of the implementation process.

USE BY EMPLOYMENT AGENCIES

4.14 In an employment agency, where the worker is subject to control as to how they perform their services, the agency deducts income tax (via Pay As You Earn (PAYE)) and NICs from the fee paid to the worker. The agency must also pay employer's NICs on these payments to the worker. This treatment is determined by current legislation² which deems such payments to be employment income.

4.15 However, where the agency is paying an intermediary company there is no requirement to deduct the worker's income tax and NICs, or to pay employer's NICs on the worker's fee. There is therefore an obvious incentive for agencies to encourage workers to use intermediary structures such as umbrella companies.

4.16 There may be further financial incentives for agencies or their staff who refer workers to particular umbrella structures. For example, there is anecdotal evidence of instances where the agency or staff member receives a payment from the umbrella company for each worker referred to them.

4.17 There is some evidence that workers may in some cases be encouraged or, exceptionally, forced to use umbrella structures by the employment agency through which they are obtaining work or by the end client they are working for (see Box 4.4).

Box 4.4: Case study

Worker A believed that she was providing self-employed services to an end client through an employment agency. The "agency" subsequently paid the worker providing a payslip which showed income tax, employee's and employer's national insurance contributions deducted via PAYE. The worker queried with HM Revenue and Customs (HMRC) what the "agency" had done. The existence of a deduction for employer's national insurance contributions clearly indicates the worker was in fact working through an umbrella company although she was not aware of this or what it meant in practice.

THE EXTENT OF USE OF UMBRELLA COMPANIES

Number of workers **4.18** HM Revenue and Customs (HMRC) estimates the number of individuals working through umbrella companies in 2007/08 at around 100,000. There is a degree of uncertainty around these numbers, but the evidence suggests that there has been an increase following the introduction of legislation on MSCs which took effect in April 2007. It is estimated that the number of workers in umbrella companies has grown by around 50 per cent over the previous year.

Number of umbrella companies **4.19** The number of umbrella companies is estimated at approximately 120, although there are suggestions that this figure could be higher. Umbrella companies are not specifically identified in HMRC data and, while many umbrella companies are well publicised, others, particularly the smallest companies aimed at niche markets, will have a very low profile and are not easy to identify.

² Chapter 7, Part 2, Income Tax (Earnings and Pensions) Act 2003 and Social Security (Categorisation of Earners) Regulations 1978.

4.20 It appears that a small number of umbrella companies employ a significant proportion of umbrella workers, with each of these having several thousand workers, whilst the rest of the sector is made up of considerably smaller companies. Data achieved from consultation will help to confirm this.

Sectors 4.21 Umbrella workers operate across all sectors in the economy, wherever temporary workers are engaged. There is some concentration of umbrella workers in certain sectors, such as engineering, IT and construction. Specialist niche providers have focused on specific areas, such as healthcare, although the numbers here are believed to be small.

4.22 Umbrella workers range from highly skilled professionals commanding high rates for their work, to unskilled, low-paid workers.

The economy and the temporary labour market

4.23 The UK labour market is characterised by adaptability and flexibility to promote employability and competitiveness. Umbrella companies are an established part of that labour market and, although they account for a relatively small percentage of temporary or agency workers, may contribute to that flexibility for both workers and businesses engaging temporary workers.

4.24 Workers may find that they prefer operating through an umbrella company because of the administrative ease it offers, and this may encourage them to seek temporary work, when they otherwise would not.

4.25 The tax and NICs saving that arises from the use of an umbrella company may help suppress the rates charged to end clients using temporary workers, encouraging businesses to engage temporary workers where they might not have done (either at all or in place of permanent employees).

Questions for consultation

4. The use of umbrella companies

a) What influences workers to use umbrella companies? How significant are these factors in relation to each other? Why do workers choose umbrella companies over alternative options?

b) What is your view of the Government's assessment of the number of umbrella companies and workers using them? If your assessment is different, on what basis have you reached your conclusions?

5

EMPLOYMENT AGENCIES AND OVERARCHING EMPLOYMENT CONTRACTS

5.1 It has now become commonplace for all types of temporary workers to find work through employment agencies. This reflects the commercial reality that end clients wish to obtain the specified services of a person or persons for given periods, and that they frequently have neither the resource nor expertise to find the right person. Equally, from the worker's perspective it is often difficult to source work directly. Employment agencies range both in size and type: from the large household name generalists placing thousands of workers a week, to the small specialist agencies placing handfuls of workers a week.

5.2 As explained in Chapter 2, traditionally agency workers have been engaged by employment agencies under agency contracts whereby the worker is not an employee of the agency. Under an agency contract, whether income tax and national insurance contributions (NICs) are deducted is determined by legislation which deems workers' income to be employment income where certain criteria are met.

AGENCY OVERARCHING EMPLOYMENT CONTRACTS

5.3 Rather than engage their workers under a normal agency contract, some employment agencies use overarching contracts of employment. Where this is the case, the agency takes the worker on as an employee under an overarching employment contract that provides ongoing mutuality of obligations. Typically, an overarching employment contract will offer a minimum work guarantee. Where there is a minimum work guarantee and other features of the contract mean it is an employment contract, the worker is treated as having an ongoing employment with the agency rather than a series of separate employments or engagements with the agency. This arrangement works in a similar way to that used by an umbrella company. The end client pays the agency for the worker's services. The agency takes its fee and pays the worker a salary and any expenses due, deducting the worker's income tax and NICs from his salary, and accounting for employer's NICs.

WHY DO SOME AGENCIES USE OVERARCHING EMPLOYMENT CONTRACTS?

Travel expenses **5.4** Some agencies use overarching employment contracts because they allow their workers to have access to tax relief for travel and subsistence expenses. The way in which employment agencies are able to give their workers this relief is described at Chapter 3.

Commercial advantages **5.5** Some agencies use overarching contracts in order to increase their competitiveness in the agency sector. Not only are their workers given the advantage of claiming tax and NICs-free travel expenses, but the agency can also reduce the employer's NICs it has to pay. As a result, it can either attract workers in a competitive market by paying a higher rate of pay or reduce its own overheads. An employment agency may also be more attractive to a worker because he or she is an employee of the employment agency and therefore is entitled to employment rights. The agency may also use the offer of a minimum work guarantee to attract workers.

THE USE OF AGENCY OVERARCHING EMPLOYMENT CONTRACTS

Numbers of agencies and workers

5.6 It is difficult to ascertain the extent to which employment agencies use overarching contracts of employment since agencies have no obligation to provide this information to HM Revenue and Customs (HMRC) as part of normal administrative processes. Normally, the only way it is possible to establish whether an agency is using such a contract is through HMRC specifically questioning an agency's contractual arrangements, or where the agency contacts HMRC to obtain an opinion on a contract it is using, or when applying for a dispensation.

5.7 However, HMRC has identified a number of employment agencies which use these types of contract. At least one of the largest employment agencies has taken on its entire temporary workforce as employees using overarching contracts, and a number of other large employment agencies employ some, but not all of their temporary staff. There is evidence that within the largest employment agencies, which represent around half of the total agency workforce,¹ at least 225,000 workers out of 440,000 are engaged under overarching contracts. It is difficult to state with any certainty the number of workers employed by agency overarching contracts in the rest of the sector, since data from compliance activity are not readily available.

Questions for consultation

5. Employment agencies

- a) What influences agencies to use overarching contracts of employment?
- b) How prevalent is the use of overarching contracts in the agency sector (number of agencies and number of workers)? How prevalent is the use of these contracts by smaller employment agencies? On what basis have you reached your conclusions?
- c) Has the use of overarching employment contracts increased recently and do you expect it to grow?

¹ Recruitment and Employment Confederation's Recruitment Industry Census 2006 estimates 1.08 million agency workers in work. There are a number of sources estimating the number of agency workers in the UK and the Department for Business Enterprise and Regulatory Reform is undertaking its own research to verify industry estimates.

6

POTENTIAL PROBLEMS WITH OVERARCHING EMPLOYMENT CONTRACTS

6.1 The two structures examined in this document using overarching employment contracts - employment agencies and umbrella companies - are an established part of the flexible labour market and many workers benefit from working through them. However, there are a number of potential problems arising from the use of such contracts.

Compliance

6.2 There is evidence of poor compliance by umbrella companies and agencies using overarching employment contracts. Although the use of dispensations is a practice that HM Revenue and Customs (HMRC) encourages because of the mutual benefits for HMRC and employers, compliance teams have found that some umbrella companies and employment agencies often urge their employees to claim the maximum amount their dispensation allows, regardless of whether these expenses were actually incurred, or that the underlying journey actually qualified for relief. Some umbrella companies market their company on the strength of their dispensation from HMRC (see Box 6.1).

Box 6.1: Advertising by umbrella company about dispensations

“What makes XXX so unique from other management companies? XXX has a very generous dispensation scheme approved by the Inland Revenue.”

Source: *umbrella company website*

6.3 Encouraging workers to claim expenses that were not genuinely incurred is a clear abuse of the dispensation procedure. It allows the umbrella company or employment agencies to pay a higher proportion of a worker’s salary free of income tax and NICs – boosting the worker’s take home pay, and lowering the umbrella company or agency’s NICs liability for that employee.

6.4 Evidence, both from HMRC compliance activity and anecdotally from the sector, suggests that the abuse of dispensations by umbrella companies is widespread, although the extent to which they are abused varies.

Collection problems **6.5** Where HMRC identify, through an enquiry, that an umbrella company or agency has failed to apply the travel expenses rules correctly and therefore owes income tax and NICs there can be further problems. It can be difficult for HMRC to collect the tax due since umbrella companies may have little or nothing in the way of tangible assets and can simply wind up and move their workers to a new company.

Unfair competition **6.6** Those umbrella companies or agencies which are compliant with the travel expenses rules are at a competitive disadvantage since they are not able to offer their workers such large income tax and NICs-free travel expenses payments.

Fairness in the tax system

6.7 Currently, those workers operating through an umbrella company or employment agency using overarching employment contracts are able to receive tax relief for travel expenses between home and work that is not available to other workers working in similar circumstances. This raises issues of fairness within the temporary labour market. For example, a worker at a factory, who has been placed there by an agency using an overarching employment contract, or who is working through an umbrella company, can receive tax relief for travel expenses. His colleague, working in the same role alongside him, who has been placed at the factory by an employment agency not using these contracts, and is not working through an umbrella company (like the vast majority of temporary workers), cannot receive tax relief for similar travel expenses. Nor would a temporary employee directly employed by the factory be entitled to tax relief.

6.8 It was not the original intention that relief should be given for such home to work journeys and the Government is concerned to maintain the principle of fairness in the tax system. It is unfair that some get tax relief when others working in similar circumstances do not.

Exchequer risk

6.9 The current rules allow some temporary workers to pay less income tax and national insurance contributions (NICs) than they would in other structures and less employer's NICs is paid. The tax and NICs is further reduced where there is poor compliance with the rules and where umbrella companies or employment agencies escape their debts.

6.10 At present it is believed the cost to the Exchequer from these structures to obtain tax relief for travel is at least £300m. If the current legislation remains in place, there is a risk that more and more temporary workers will move to work through umbrella companies or employment agencies using overarching employment contracts in order to gain the tax advantages they offer.

Casualisation of the workforce

6.11 Temporary and agency work can be a flexible alternative to permanent employment, giving employers the ability to meet seasonal or short-term surges in demand and individuals the ability to balance domestic and work commitments or as a route back in to employment. However, there is also a risk that these structures offer end clients a convenient alternative to taking workers on directly as employees, so that casualisation of the workforce is encouraged. To the extent that such casualisation substitutes temporary work in place of offers of permanent work (to workers who would like permanent employment) and thereby potentially constrains progression in the labour force and investment in an individual's development, it is not something to be encouraged.

Exploitation

6.12 Some workers may have little choice about whether they work through an umbrella company. For example, there is anecdotal evidence that some employment agencies will not take on workers unless they are operating through an intermediary such as an umbrella company. Even where the worker has a choice, he or she may not

understand the consequences of working through an umbrella company, or with an agency using an overarching employment contract. One of the consequences of salary sacrifice is that the worker pays less NICs but, by cutting their contributions, workers may not pay enough to allow them to access certain benefits. In addition, some low paid workers may not realise that working through an umbrella company might actually mean they take home less pay if the fee paid to the umbrella outweighs the value of the relief on any expenses they are able to claim. There are also cases where workers are unaware that they are working through an umbrella company at all.

6.13 One of the features umbrella companies highlight in their advertising material is the fact that the worker is an employee of the umbrella company, and this brings extra benefits such as holiday pay. However, this can be misleading for workers: the worker in fact funds many of these benefits directly as they are taken out of the amount paid for the worker's service, but this is not always clear to workers.

6.14 Some umbrella companies and employment agencies may encourage workers to enter into these arrangements by the promise of tax-free travel expenses which are advertised at a rate far greater than they could ever properly claim. For example, one umbrella company advertises on its website that its workers will take home a minimum of 85 per cent of their gross contract value. It is likely that this company is encouraging its workers to claim for expenses that they have not incurred since even using a salary sacrifice arrangement it would be difficult to minimise income tax and NICs payments to only 15 per cent of a worker's salary with genuine expenses.

6.15 HMRC is also aware of cases where workers have been required to pay administration fees to cover the cost to the employment agency of administering arrangements to pay income tax and NICs free travel expenses, reducing the worker's take home pay. As a result, the agency gains a substantial part of the income tax and NICs advantages that should properly lie with the worker who has incurred the cost of travel between home and work. A number of workers have also complained about being given little or no choice over whether to sign up to the arrangements. Often this involves vulnerable workers who are paid at the lower end of the pay scales.

Questions for consultation

6. Potential problems with overarching contracts

- a) What is the extent of the problems outlined?
- b) Are there any further problems?
- c) What is the extent of non-compliance with the travel expenses rules?
- d) What factors are contributing to the abuse of the travel expenses rules? What practical measures could be taken to address this?

It would be helpful to know the basis on which you have reached your conclusions in relation to all of these questions.

7

ACTION TO ADDRESS THE PROBLEMS IDENTIFIED

7.1 Evidence from this consultation will help to identify whether action is needed regarding tax relief for travel expenses for temporary workers.

7.2 Two broad options for action have been identified:

- Allow the existing arrangements to continue but introduce legislation to tackle non-compliance; or
- Remove entitlement to tax relief for travel expenses for umbrella companies and employment agencies using overarching employment contracts.

Allow the existing arrangements to continue but introduce legislation to tackle non-compliance

7.3 This option would mean that the existing rules on travel expenses and dispensations would continue to apply but stronger action would be taken to address non-compliance. This might take the form of legislation to introduce a transfer of debt provision similar to that introduced with the Managed Service Company legislation in 2007. This would ensure that where compliance activity identified failures to apply the relevant legislation, the resultant income tax and NICs underpaid would be recovered from specified third parties where the sums prove irrecoverable from the umbrella company or employment agency.

Remove the entitlement to tax relief for travel expenses for umbrella companies and employment agencies using overarching contracts.

7.4 Umbrella companies and employment agencies using overarching employment contracts to enable temporary workers to obtain relief for travel between home and work by linking together a series of unrelated engagements so that there is one single ongoing employment. Legislation could be introduced so that each engagement is treated as one of a series of separate employments for the purposes of the travel expense rules.

7.5 Each engagement when the worker's services are supplied to a third party could be deemed to be treated as a separate employment for the purposes of the travel expenses rules. This would mean that where the worker spends all or almost all of the period he is working on a particular engagement at the client's premises, this would be treated as a permanent workplace.

7.6 In these circumstances relief would not be due for travel expenses for travel between home and the workplace or while at the workplace.

7.7 Any legislation to achieve this would be drafted to ensure that it did not change the existing provisions in relation to personal service companies (PSCs) and managed service companies (MSCs) as they apply to expenses.¹

¹ Chapters 8 and 9, Part 2, Income Tax (Earnings and Pensions) Act 2003

Alternative courses of action

7.8 There may be other approaches to address the problem of non-compliance with the existing rules on travel expenses or to address the wider questions on the use of these structures to obtain relief. The Government would be interested in any proposals for alternative courses of action.

7.9 It always remains an option to leave the existing legislation unchanged if the evidence from the consultation demonstrated that the potential problems outlined in chapter 6 were not significant or that there were negative consequences for business and the sector which outweighed the benefits of taking action. If this were the position, it would be open to Government to review the position again at a later date.

Questions for consultation

7. Action to address the problems identified

- a) How well would each option address the problems highlighted in chapter 6?
- b) What effect would each option have on:
 - a. The temporary labour market?
 - b. End clients?
 - c. Employment agencies?
 - d. Umbrella companies?
 - e. Workers?

You might consider such aspects as the impact on costs for businesses, rates paid for temporary labour, and what alternative structures might be used.

- c) Are there any alternative courses of action the Government could take?

8

CONSULTATION PROCESS

Analysis of the sector

8.1 The Government is seeking to expand and test its analysis of those structures using overarching employment contracts - umbrella companies and employment agencies – and would also welcome comments on the possible options to address the problems caused by those structures.

Chapter 4 The use of umbrella companies

- a) What influences workers to use umbrella companies? How significant are these factors in relation to each other? Why do workers choose umbrella companies over alternative options?
- b) What is your view of the Government's assessment of the number of umbrella companies and workers using them? If your assessment is different, on what basis have you reached your conclusions?

Chapter 5 Employment agencies and overarching employment contracts

- a) What influences employment agencies to use overarching employment contracts?
- b) How prevalent is the use of overarching employment contracts in the agency sector (number of agencies and number of workers)? How prevalent is the use of these contracts by smaller employment agencies? On what basis have you reached your conclusions?
- c) Has the use of overarching employment contracts increased recently and do you expect it to grow?

Chapter 6 Potential problems with overarching employment contracts

- a) What is the extent of the problems outlined?
- b) Are there any further problems?
- c) What is the extent of non-compliance with the travel expenses rules?
- d) What factors are contributing to the abuse of the travel expenses rules? What practical measures could be taken to address this?

It would be helpful to know the basis on which you have reached your conclusions in relation to all of these questions.

Chapter 7 Action to address the problems identified

- a) How well would each option address the problems highlighted in chapter 6?
- b) What effect would each option have on:
 - a. The temporary labour market?
 - b. End clients?
 - c. Employment agencies?
 - d. Umbrella companies?
 - e. Workers?

You might consider such aspects as the impact on costs for businesses, rates paid for temporary labour, and what alternative structures might be used.

- c) Are there any alternative courses of action the Government could take?

PROCESS AND TIMETABLE FOR CONSULTATION

- 8.2** Comments on this consultation should be sent by 13 October 2008 to:

Lucy Cowan

Travel expenses consultation

Personal Tax Team

HM Treasury

2/SE

1 Horse Guards Road

London

SW1A 2HQ

Or e-mail travelconsultation@hm-treasury.x.gsi.gov.uk

Telephone queries: 0207 270 5176

About the consultation process

- 8.3** This consultation has been conducted in accordance with the consultation criteria in the Department for Business Enterprise & Regulatory Reform Code of Practice. If you wish to access the full version of the Code, you can obtain it at:

<http://bre.berr.gov.uk/regulation/consultation/code/>

The consultation criteria

Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.

Be clear about who may be affected, what questions are being asked, and the timescale for responses.

Ensure that your consultation is clear, concise and widely accessible.

Give feedback regarding the responses received and how the consultation process influenced the policy.

Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.

Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

If you feel that the consultation does not satisfy these criteria, or if you have any complaints about the process, please contact:

Richard Bowyer

Better Regulation Unit

100 Parliament St

London

SW1A 2BQ

020 7147 0062 or richard.bowyer@hmrc.gsi.gov.uk

Confidentiality Disclosure 8.4 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

8.5 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

8.6 The Department will process your personal data in accordance with the DPA and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.



IMPACT ASSESSMENT

Summary: Intervention & Options		
Department /Agency: HMT	Title: Impact Assessment of tax relief for travel expenses: temporary workers and overarching employment contracts	
Stage: Consultation	Version: Final	Date: 30 June 2008
Related Publications: Tax relief for travel expenses: temporary workers and overarching employment contracts		

Available to view or download at:

http://www.hm-treasury.gov.uk/consultations_and_legislation/consult_liveindex.cfm

Contact for enquiries: Lucy Cowan

Telephone: 020 7270 5176

What is the problem under consideration? Why is government intervention necessary?

There is evidence suggesting that there is widespread failure amongst umbrella companies and agencies using overarching employment contracts to comply with the rules on travel expenses and dispensations. In addition, under the current income tax rules temporary workers engaged under an overarching employment contract by umbrella companies and some employment agencies are able to obtain tax relief for those travel expenses which would not be available to other workers in similar circumstances. This raises issues of fairness within the temporary labour market and it also puts businesses that do not use overarching employment contracts at a competitive disadvantage. Government has therefore decided to carry out a consultation to test its initial analysis of the use of these contracts and the extent of compliance with the travel expenses rules.

What are the policy objectives and the intended effects?

The government is consulting on the use of overarching employment contracts by structures such as umbrella companies and employment agencies to establish whether action should be taken to restrict access to tax relief for home to work travel through these sorts of structures, and if action were to be taken, what this should consist of.

What policy options have been considered? Please justify any preferred option?

The options that have been identified are as follows:

- Allow the existing arrangements to continue but introduce legislation to tackle non-compliance.
- Remove entitlement to tax relief for travel expenses for umbrella companies and employment agencies using overarching contracts.
- Allow the existing arrangements to continue unchanged.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? A further impact assessment taking into account stakeholders' responses to the consultation will be produced prior to implementation.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: 

.....Date: 30/06/2008

Summary: Analysis & Evidence

Policy Option: 1	Description: Allow the existing arrangements to continue but introduce legislation to tackle non-compliance.
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' Where HMRC has to invoke the legislation there might be a compliance cost to the specified third party. However, HMRC does not expect to have to invoke the legislation too often because any measure would act as a deterrent to non-compliance.
	One-off (Transition)	Yrs	
	£ Neg.		
	Average Annual Cost (excluding one-off)		
	£ Neg.		Total Cost (PV) £
Other key non-monetised costs by 'main affected groups' Where it is found that arrangements are not implemented in line with the tax rules there will be a cost to the offending business in making good the tax loss to the exchequer. This cost might fall to a specified third party if the company concerned cannot meet the liability.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'
	One-off	Yrs	
	£ Neg.		
	Average Annual Benefit (excluding one-off)		
	£ Neg.		Total Benefit (PV) £
Other key non-monetised benefits by 'main affected groups' Compliant businesses would be better able to compete if HMRC compliance effort is backed up by legislation to counter non-compliance. The unfair advantages currently enjoyed by the non-compliant would be removed.			

Key Assumptions/Sensitivities/Risks Exchequer yield will increase. This would be due to increased compliance as a result of legislation to recover unpaid tax and NIC from third parties. However, there is a risk that this option would still be seen as a tacit endorsement from the government that it is acceptable to engage temporary workers under overarching contracts to gain a tax advantage.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	
Which organisation(s) will enforce the policy?	HMRC
What is the total annual cost of enforcement for these organisations?	£
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£ 0
What is the value of changes in greenhouse gas emissions?	£ 0
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro Small Medium Large
Are any of these organisations exempt?	No No N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ Neg.	Decrease of £	Net Impact £ Neg.

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 2	Description: Remove entitlement to tax relief for travel expenses for umbrella companies and employment agencies using overarching contracts.
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' For those businesses that use overarching employment contracts there will be a one-off familiarisation with changes plus changes to the systems and processes and ongoing data capture for travel and subsistence expenses.
	One-off (Transition) Yrs		
	£ TBC		
	Average Annual Cost (excluding one-off)		
	£ TBC	Total Cost (PV)	£
Other key non-monetised costs by 'main affected groups' The take home income of workers currently engaged under overarching employment contracts would decrease if employers do not increase their gross wage to compensate them for the loss.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'
	One-off Yrs		
	£		
	Average Annual Benefit (excluding one-off)		
	£	Total Benefit (PV)	£
Other key non-monetised benefits by 'main affected groups' A level playing field for all businesses involved in the engagement/placement of temporary workers - no tax advantage for workers engaged under overarching employment contracts over those who are not. This may lead to increased competition and be beneficial to temporary workers.			

Key Assumptions/Sensitivities/Risks The existing exchequer loss of at least £300m would reduce. The extent of reduction would depend on the behavioural response of umbrella companies, employment agencies and the workers.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?					
Which organisation(s) will enforce the policy?	HMRC				
What is the total annual cost of enforcement for these organisations?	£ No change				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	Yes				
What is the value of the proposed offsetting measure per year?	£ 0				
What is the value of changes in greenhouse gas emissions?	£ 0				
Will the proposal have a significant impact on competition?	Yes				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> </table>	Micro	Small	Medium	Large
Micro	Small	Medium	Large		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £ TBC	Decrease of £	Net Impact £ TBC

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Summary: Analysis & Evidence	
Policy Option: 3	Description: Allow the existing arrangements to continue unchanged.

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'
	One-off (Transition)	Yrs	
	£ Neg.		
	Average Annual Cost (excluding one-off)		
	£ Neg.		Total Cost (PV)
			£
Other key non-monetised costs by 'main affected groups'			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups'
	One-off	Yrs	
	£ 0		
	Average Annual Benefit (excluding one-off)		
	£ 0		Total Benefit (PV)
			£
Other key non-monetised benefits by 'main affected groups'			

Key Assumptions/Sensitivities/Risks Risk that the number of workers engaged under overarching employment contracts could increase from around 100,000 in 2007/08 to as much as 240,000 by 2012/13, with consequent tax loss increasing from £300 million to £650 million.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	
Which organisation(s) will enforce the policy?	HMRC
What is the total annual cost of enforcement for these organisations?	£ 0
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	Yes
What is the value of the proposed offsetting measure per year?	£ 0
What is the value of changes in greenhouse gas emissions?	£ 0
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro Small Medium Large
Are any of these organisations exempt?	No No N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of	£ Neg.	Decrease of
	£	Net Impact
		£ Neg.

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Background

By working under an overarching employment contract for structures such as an umbrella company or an employment agency, some temporary workers are able to be paid travel expenses free of income tax and national insurance contributions (NICs).

Umbrella companies are set up by providers who take a monthly fee from the worker, and in turn handle their pay and tax matters. The worker is not directly involved in the running of the company in any way. Umbrella companies do not source work for the worker; the worker will usually arrange temporary work through an employment agency or directly with a client.

An overarching employment contract allows temporary workers to link a series of separate engagements into a single ongoing employment with the umbrella company or employment business. Consequently, the umbrella company or employment business is able to treat each engagement as a temporary place of work and use the temporary workplace rules¹ to pay tax- and NICs-free travel expenses in circumstances where this would not normally be possible. This is because under the current tax rules, generally only workers who travel between home and a temporary workplace get tax relief on travel expenses. The single, ongoing employment arrangements enable short-term engagements, which would otherwise be treated as permanent places of work, to be treated as temporary places of work.

It is important to note that the use of overarching contracts allows workers to obtain tax relief for travel expenses, but in most cases the travel expenses are not paid on top of the worker's salary, rather they are paid as part of a salary sacrifice arrangement. These enable a portion of the worker's salary to be paid instead as travel expenses, free of income tax and NICs, in lieu of this portion.

The benefit of the reduced tax and NICs is split between the worker and the umbrella company or employment agency. The worker benefits as he receives a proportion of his money free of the tax and NICs which would otherwise have been due and in this way increases his take home pay. The worker's employer also benefits from the fee charged to workers and because the amount of salary is reduced on which employer's NICs is paid.

An umbrella company or an employment agency (like other employers) can obtain a dispensation from HMRC that includes an agreement to pay scale rate subsistence allowances. A scale rate subsistence allowance is an allowance which HMRC has agreed can be paid tax- and NICs-free to an employee without any records having to be kept. If a dispensation includes such an agreement, this means that the umbrella company or employment business can pay the worker's travel expenses, without having to report these expenses to HMRC.

Dispensations are issued in order to reduce administrative burdens on businesses and HMRC and are often accompanied by an agreement to pay scale rate subsistence payments. Subsistence expenses are a common example of expenses which employers choose to reimburse by means of a scale rate payment rather than by reimbursing the actual expenditure incurred. Any dispensation given to a business by HMRC will set out the circumstances and amounts that can be claimed for that expense without any associated payment being reported.

Although dispensations provide significant advantages to both the employer and HMRC, there is evidence that umbrella companies and employment agencies often urge their employees to claim the maximum amount their dispensation allows, regardless of whether these expenses were genuinely incurred. Encouraging workers to claim expenses that were not genuinely incurred is a clear abuse of the travel expenses rules. It allows the umbrella company or employment agency to pay a higher proportion of a worker's salary free of tax and NICs – boosting the worker's take home pay, and lowering the umbrella company or agency's NICs liability for that employee.

Evidence from HMRC compliance activity suggests that the abuse of dispensations by umbrella companies and employment agencies using overarching employment contracts is widespread, although the extent to which they are abused varies. Those few which are genuinely compliant are therefore at a competitive disadvantage since they are not able to offer their workers such large tax- and NICs-free travel expenses payments: workers will only be paid what they have genuinely incurred.

¹Section 339 Income Tax (Earnings and Pensions) Act 2003

In addition, compliance problems are exacerbated by the fact that it is difficult for HMRC to collect the tax and NICs due. Umbrella companies and employment agencies have no or little in the way of tangible assets and therefore, if challenged, can simply wind up and move their workers to a new company.

There have also been concerns raised about the potentially exploitative use of umbrella companies and employment agencies using overarching employment contracts, to push workers into them, who may have no choice in the matter, and may not understand fully the consequences of working through these structures.

Rationale for Government intervention

Compliance

Tax is lost through poor compliance by umbrella companies and some employment agencies. The evidence suggests that there is widespread abuse of the travel expenses rules and in particular, the dispensations granted to these businesses by HMRC. Workers engaged under overarching employment contracts are often encouraged to claim the maximum amount of the scale rate agreed regardless of whether expenses were actually incurred. By abusing dispensations in this way a greater proportion of the workers' remuneration package is paid as a tax and NICs – free travel expenses payment (through salary sacrifice). The worker takes home more pay and the employer pays less employer NICs. Moreover, even if HMRC does identify through an enquiry that a company has failed to apply the travel expenses rules correctly and therefore owes HMRC tax and NICs, it can be difficult to collect the tax and NICs due since umbrella companies and employment agencies have little or no assets and can simply wind up and move their workers to a new company.

Competitiveness

Employment agencies that do not offer overarching employment contracts to their workers are currently at a competitive disadvantage because they cannot pay tax and NICs free travel and subsistence payments to enhance the take home income of the workers.

Fairness

The Government is aware of the importance of the temporary labour market and the benefits it can provide both to business and to workers. However, in some cases contractual arrangements are used to obtain an unfair advantage in terms of tax and national insurance contributions.

Currently, those workers operating through an umbrella company or employment agency using overarching employment contracts are able to receive tax relief for travel expenses between home and work that is not available to other workers in similar circumstances. This raises issues of fairness within the temporary labour market. For example, a worker at a factory, who has been placed there by an agency using an overarching employment contract, or who is working through an umbrella company, can receive tax relief for travel expenses. His colleague, working in the same role alongside him, who has been placed at the factory by an employment agency not using these contracts, and is not working through an umbrella company (like the vast majority of temporary workers), cannot receive tax relief for similar travel expenses. Nor would a temporary employee directly employed by the factory be entitled to tax relief.

It was not the original intention that relief should be given for home to work journeys and the Government is concerned to maintain the principle of fairness in the tax system.

Exchequer Risk

The current rules allow temporary workers engaged under overarching employment contracts by umbrella companies and some employment agencies to pay less income tax and NICs than they would in other structures. This sort of arrangement also allows the umbrella company or employment agency to pay less employer's NICs. The tax and NICs are further reduced where there is poor compliance with the travel rules.

Currently at least £300m is lost through relief for travel expenses being granted to temporary worker in situations where it would not normally be available. If the current legislation remains unchanged, there is a risk that more and more temporary workers will move to work through umbrella companies or employment agencies using overarching contracts in order to gain the tax and NICs advantages they offer, which could increase this figure. Any action taken could help prevent an increase in this exchequer loss.

Exploitation

Where umbrella companies are concerned, some workers may have little choice as to whether they work through such a company. For example, where an employment agency might agree to place a worker only if he is in an umbrella company. And even where the worker has a choice, they may not understand the consequences of entering such an arrangement.

Additionally, one of the features umbrella companies highlight in their advertising material is the fact that the worker is an employee of the umbrella, bringing benefits such as holiday pay. However, this can be misleading for workers: the worker in fact funds many of these benefits directly – they are taken out of the amount paid for the worker’s services by the client or agency to the umbrella company.

Policy objective

This consultation seeks to test our initial analysis of the use of overarching employment contracts by structures such as umbrella companies and employment agencies, including the size of the sector, any advantages or disadvantages these structures bring, and the extent of the abuse of the travel expenses rules. It also suggests possible solutions to the problems outlined in the consultation document, seeks to ascertain what effect these options would have on the temporary labour market, and asks for any other proposed solutions to the problems identified.

Sectors affected

The compliance costs of intervention will affect all umbrella companies and some employment agencies operating in the UK which currently engage temporary workers under overarching employment contracts. It will also affect the temporary workers who are currently engaged under these contracts.

Estimates of population and exchequer costs

The Government estimates that there are around 120 umbrella companies operating in the UK which use overarching employment contracts, and they employ around 100,000 temporary workers at any one time. The exchequer loss on tax and NICs free travel expenses paid to these workers is currently estimated at around £250m per annum and possibly much higher depending on the typical expenses claim made. The Government believes that this figure would significantly increase if no action is taken.

HMRC compliance activity has identified that the average claim ranges from £5,000 (resulting in £2,500 tax/NIC lost per worker) up to £20,000 (resulting in £10,000 lost per worker). The distribution assumed is as follows (but is not based on hard data):

Expenses claim	£5,000	£10,000	£15,000	£20,000
Proportion of workers	80%	16%	3%	1%

It is estimated that there has been a significant growth in numbers of workers in the latest year and assumed that, unchanged, number of workers in umbrella companies will grow at close to this rate as follows (thousands):

	07/8	08/9	09/10	10/11	11/12	12/13
Best Estimate	100	115	140	170	200	240
Assumed % growth		+15%	+20%	+20%	+20%	+20%

It is assumed that, even with enhanced compliance effort, the number of workers in umbrella companies will continue to grow but the rate will moderate after the first year as follows (thousands):

	07/8	08/9	09/10	10/11	11/12	12/13
Best Estimate	100	115	125	140	150	170
Assumed % growth		+15%	+10%	+10%	+10%	+10%

The exchequer loss from employment agencies which use overarching employment contracts is more difficult to quantify because the extent to which employment agencies are using these contracts is still unknown. However HMRC compliance staff have identified a number of large employment agencies which use these contracts. At least one of the largest employment agencies has taken on its entire temporary workforces as employees using overarching employment contracts, and a number of other large employment agencies employ some, but not all of their temporary staff. These companies alone

represent approximately 440,000 temporary workers, although the actual number of workers employed by these employment agencies will be lower than this since not all of the agencies' workforces have been taken on as employees and not all the workforce will be in work at any one time. It is estimated that at least 225 thousand workers are employed and one in five of the workforce is in work at any one time. The potential tax loss is estimated to be in the region of £50-75m for the largest agencies. The incidence amongst smaller agencies is unknown.

Policy options

Option 1: Allow the existing arrangements to continue but introduce legislation to tackle non-compliance

This would mean leaving the existing legislation unchanged so that workers employed under overarching employment contracts by umbrella companies and employment agencies remain entitled to tax relief for travel between home and work. Where HMRC compliance activity identifies a failure to comply with the tax rules, such as abuse of dispensations, the business concerned is required to pay the tax and NIC due. However, as most structures using overarching employment contracts have no assets, it is often very difficult for HMRC to collect the tax and NIC owed. To overcome this it is proposed that a transfer of debt provision, similar to the one included in the MSC legislation in 2007, is introduced. This would allow HMRC to collect the unpaid tax and NIC liability from a specified third party e.g. the end client, employment agency or even the employee. This means that where a business could not pay its debt to HMRC, there would be a cost to the specified third party, whereas previously the debt was treated as unrecoverable.

Costs

On the available evidence HMRC does not expect there to be any significant impacts on ongoing administrative burdens or other compliance costs to business. However, where there is non-compliance with the rules and the business concerned is unable to pay the underpaid tax and NICs to HMRC, there may be a cost to the specified third party if the new legislation is invoked. This cost is difficult to quantify because it would depend on how umbrella companies and employment agencies respond to the new rules. However, HMRC does not expect to have to invoke the legislation too often because any measure would act as a deterrent to non-compliance.

Even with the introduction of the new legislation it is estimated that the exchequer would continue to lose tax revenues but this should be lower than the current estimated loss.

Businesses that do not offer overarching employment contracts would continue to be disadvantaged and there would be a significant risk that they too would start using similar structures in order to be able to compete.

Benefits

Compliant businesses would be better able to compete if HMRC compliance effort is backed up by legislation to counter non-compliance. Legislation to counter non-compliance should also lead to increased exchequer yield because the government would be in a much stronger position to recover unpaid tax and NIC from third parties should a business without sufficient assets be found to be abusing the tax rules.

In recent informal consultation with interested parties it has been suggested that umbrella companies exist to provide a low risk, easy option for administration for temporary workers. Temporary workers who do not want the responsibility of setting up and running their own company or risk being caught by the MSC legislation find this service particularly attractive.

It is also claimed that temporary workers like the security and rights that continuous employment brings. However, it is dubious whether umbrella companies and employment agencies offering overarching contracts really provide genuine employment rights. Whilst some umbrella companies take their responsibilities seriously, offering a range of HR, training and legal services, the vast majority do not.

It has also been suggested that the use of overarching employment contracts to secure relief for travel plays an important role in maintaining the flexible labour market. However, since the majority of temporary workers are not engaged under overarching employment contracts it is unlikely that this has any significant impact on the labour market.

Risks

The introduction of the transfer of debt provision might help to reduce the scope for abuse of the tax rules. However this option could be seen as tacit endorsement by the government that the use of overarching employment contracts when engaging temporary workers in order to benefit from the travel expenses rules was acceptable. There is also a risk that the temporary labour market will be distorted by end clients encouraged to casualise their workforce on the basis that workers will continue to have employment rights and receive tax free travel expenses to which they were not entitled as permanent employees.

Conclusion

Although the transfer of debt provision should help overcome some of the problems, the issue of the unfair tax and NICs advantage enjoyed by temporary workers engaged under overarching employment contracts would remain. There is also a real risk that these sorts of arrangements are seen as acceptable and give the green light for a significant expansion of activity in this area. If this were to happen, the exchequer loss might increase significantly. Non-compliance through the abuse of the tax rules and dispensations would probably get worse if any new rules were not enforced.

Option 2: Remove entitlement to tax relief for travel expenses for umbrella companies and employment agencies using overarching contracts.

The Government would introduce primary legislation in the Finance Bill to stop workers engaged through umbrella companies or through employment agencies under overarching contracts from being entitled to tax relief for home to work travel expenses and other payments. This could be achieved by legislating to deem each engagement of workers in umbrella companies and agency overarching employment contracts to be a separate employment. This would effectively remove relief for travel between home and the client's premises.

Costs

There would be ongoing cost implications for both umbrella companies and employment agencies using overarching employment contracts. Once the legislation is in place they would have to apply PAYE to almost all travel and subsistence payments they make to their workers if they choose to continue paying travel and subsistence payments. These companies would also have to account for the employer's share of NICs on previously tax-free travel expenses payments. There would also be some one-off costs associated with this option for all employment agencies, primarily in familiarisation with the revised rules and possibly with redrafting of employment contracts, as well as possible changes to payroll systems.

The net take home income of workers engaged through umbrella companies and by employment agencies using overarching employment contracts would be reduced because previously tax and NICs free travel and subsistence payments would now be subjected to PAYE. There are several possible behavioural responses to this. Workers might bear the loss; the umbrella companies or employment agencies might take part of the loss by reducing the fee that it charges workers and hence reducing their profit margin; or the workers might move to other structures (compliant or non-compliant).

There may also be an increased administrative burden for the affected businesses because they would no longer be able to use the dispensations which they currently hold to pay tax and NICs free travel expenses. This would result in an increased administrative burden since companies would have to pay these expenses through the payroll and provide HMRC with a P11D or P9D form. It is uncertain whether businesses would in fact continue to pay travel expenses but if they did not there would be no additional administration burden, and if they continued to pay travel expenses, it is estimated that the increase in burden would not be significant.

Benefits

A change in the legislation which affects umbrella companies and employment agencies using overarching employment contracts will ensure a level playing field for all those involved in the temporary labour market. Currently businesses which do not use these structures are at a disadvantage as they are unable to pay tax free travel and subsistence payments to their workers.

Although compliant businesses should benefit from a change in the rules it is not possible to quantify the benefits because this would depend on how the affected businesses respond.

The exchequer loss would reduce significantly as workers engaged by umbrella companies would no longer be entitled to tax and NICs free travel and subsistence payments.

Other issues

If the fiscal advantages of working for an umbrella or agency were removed, it is possible that some of those involved would move out of this business. If this were to happen, employment agencies that had previously depended on umbrella companies to provide the necessary administration might be forced to take on the responsibility for payrolling and other administrative services. Other possibilities are that workers might move to permanent employment, their own personal service companies or into other non-compliant structures. However, these behavioural changes are difficult to predict and it is not clear how many umbrella companies and employment agencies would continue to offer overarching employment contracts and how many would stop.

Option 3: Allow the existing arrangements to continue unchanged

It always remains an option to leave the existing legislation unchanged if the evidence from the consultation demonstrated that the potential problems outlined in chapter 6 of the consultation document were not significant, or that there were negative consequences for business and the sector which outweighed the benefits of taking action.

If this course of action were taken workers employed under overarching employment contracts by umbrella companies and employment agencies would remain entitled to tax relief for travel between home and work. However, if compliance levels remained low, it would be open to Government to review the position again at a later date.

Risks

The Exchequer would continue to lose tax revenues. Businesses that do not use overarching employment contracts would continue to be disadvantaged and there would be a significant risk that they too would start using similar structures in order to be able to compete.

This could also be seen as tacit endorsement by the government that the use of overarching employment contracts when engaging temporary workers was acceptable, even though this is done mainly to benefit from the travel expenses rules. As such, the exchequer loss may increase as overarching contracts offered by umbrella companies and agencies gain in popularity.

There is also a risk that the temporary labour market will be distorted by end clients encouraged to casualise their workforce on the basis that workers will continue to have employment rights and receive tax free travel expenses to which they were not entitled as permanent employees.

Consultation

HMT and HMRC have met a number of interested parties since the Budget announcement to find out more about umbrella companies, agency overarching contracts of employment and the part they play in the temporary labour market. They range from umbrella company providers to representative bodies for contractors and employment agencies. A number of key messages and common themes have emerged:

- Most of those consulted from the sector agreed that there is widespread abuse of the rules for travel expenses by some umbrella companies and employment agencies engaging workers under overarching employment contracts. The extent of that abuse varies from company to company.
- Some umbrella companies and employment agencies use their dispensations aggressively to market their services to temporary workers who seek work through employment agencies.
- Those umbrella companies and employment agencies which are genuinely compliant are at a competitive disadvantage to non-compliant companies, and this could push them towards non-compliance.
- Overarching employment contracts used by umbrella companies and some employment agencies provide an option that appeals to some workers for good non-tax reasons; and
- Removing umbrella companies from the market would leave a gap likely to be filled by a variety of alternative employment arrangements.

Small Firms Impact Test

A number of employment agencies and umbrella companies are small businesses. The Government will endeavour to establish a fuller picture of the potential impacts, costs and benefits for small business alongside the consultation process by undertaking a small firms impact test.

Competition Assessment

A requirement to stop making tax and NICs free travel payments to temporary workers engaged by umbrella companies and employment agencies under overarching employment contracts is not expected to result in any significant adverse competition effects or give a tax and NICs advantage to one business sector over another. In fact it would eliminate the unfair tax and NICs advantage currently enjoyed by those businesses using these structures to circumvent the rules. The Government will endeavour to test this during the consultation process.

Other Specific Impact Tests

The Government does not think that the proposals will impact on human rights, race equality, disability equality or gender equality. The Government will consider these further and report its findings in the final impact assessment.

Specific Impact Tests: Checklist

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	N/A	No
Sustainable Development	N/A	No
Carbon Assessment	N/A	No
Other Environment	N/A	No
Health Impact Assessment	N/A	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	N/A	No

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