Groundhog Day for employment allowance scam

Robin Williamson highlights egregious tax evasion schemes through the utilisation of mini-umbrella companies

While listening to BBC's File on 4 'Britain's Ghost Companies' in May, I experienced a distinct sense of déjà vu.

The programme was covering a particularly abusive tax avoidance scheme which involved a chain of intermediaries suppling workers for NHS Test and Trace. The workers' direct employers were a series of mini-umbrella companies (MUCs) recently set up with UK nationals as directors who, at some point, would hand over to foreign nationals based mostly in the Philippines. Each MUC had a short life and employed only a few UK workers at a time, and workers were frequently handed between different MUCs. The main object of the arrangements was to maximise claims for the £4,000 employment allowance and thus reduce or eliminate liability for UK secondary Class 1 national insurance contributions (NIC).

This took me back six years to when I assisted a BBC reporter in a similar investigation. That scheme worked by interposing 150 companies between the employer and the workers, and each of the 150 companies would claim the employment allowance, which was then £2,000. So if the employer's NIC bill was £300,000, 150 intermediate companies would be set up to reduce it to zero. In that particular case, when the scheme was proposed to him, the boss of the recruitment agency which was the employer felt uncomfortable enough to alert the BBC.

It was clear to me at the time that not only was the scheme abusive, it did not work. The relevant legislation in section 2 of the National Insurance Act 2014 which introduced the allowance reads as follows:

'(10) A person cannot qualify for an employment allowance for a tax year if, apart from this subsection, the person would qualify in consequence of avoidance arrangements. …

(12) In subsection[s] (10) … "avoidance arrangements" means arrangements the main purpose, or one of the main purposes, of which is to secure that a person benefits, or benefits further, from the application of the employment allowance provisions.

(13) In subsection (12) "arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).'

That arrangement, and those reported on by the BBC, both involved a series of companies set up as intermediaries between an employer and its employees wholly or mainly for the purpose of claiming additional employment allowances, and so fall squarely within the scope of those anti-avoidance provisions. While the scheme I looked at in 2015 was simple - almost brazen - the current variant, like the mutation of some virulent bug, has evolved into something far more intricate.

The employment allowance

The employment allowance was introduced in 2014 in order to encourage small businesses to take on staff. It reduces an employer's Class 1 NIC bill by up to £4,000 in a tax year. Most employers and charities are eligible, including (since 2015) an employer of a care and support worker (someone who takes on personal care of an older, vulnerable or disabled person). Those not eligible include non-charitable public authorities or businesses that do more than half their work in the public sector, people who employ purely domestic workers such as a nanny or gardener, and larger concerns with a secondary Class 1 liability of £100,000 or more. In order to claim, you simply put an entry in the appropriate box on the PAYE software.

The intention of Parliament in introducing the allowance was to enable a small business taking on staff to claim an amount off its NIC bill – not that amount multiplied by however many intermediaries it might set up for the sole purpose of reducing its NIC bill to zero.

'Scams for scumbags'

A former permanent secretary of HMRC once memorably described certain avoidance schemes as 'scams for scumbags'. That epithet seems particularly apt to describe the present case. National insurance evasion is not the only nefarious object for which scumbags typically promote such schemes: sometimes underpayments of VAT put others in the supply chain at risk; or underpayments of PAYE prejudice the workers.

By no means are all umbrella companies tarred with the same brush. Some are legitimate, compliant and perform a useful role in the labour market, but all have acquired a bad reputation because of the egregious practices of others. The distinctions between different types of umbrella company are well set out in the March 2021 report 'Labour Market Intermediaries' by the Low Incomes Tax Reform Group (LITRG).

HMRC's role

The scheme described on File on 4 is particularly repugnant in that the promoters are taking advantage of the pandemic, not just to make use of unwitting people who are desperate for work, but also to defraud the Exchequer – apparently not for the first time, as highlighted in a 2020 article in The Guardian. Why, despite HMRC's warnings, is what is essentially the same scheme being used time and time again?

On the day of the BBC's exposure of the 2015 scheme, HMRC said they would pursue both users and promoters. They also warned of the possibility that schemes liable to register under DOTAS which had failed to do so could face penalties of up to £1 million. They now have many more powers under legislation, designed to punish promoters of tax avoidance arrangements and impose criminal penalties for failure to prevent the facilitation of tax evasion, in addition to age-old powers to investigate and proceed against fraud.

So why do such schemes still apparently thrive? The fact that the offending companies or their offshore subsidiaries go into liquidation and the money disappears long before any investigation can be completed is undoubtedly a severe challenge for HMRC. Like the seven devils in the New Testament parable, no sooner has one type of abuse been exposed and discredited than others, even more sophisticated and damaging, take its place.

The day before the BBC's latest investigation went on air, HMRC issued detailed guidance warning the employers of temporary staff to carry out due diligence checks. The day following the programme saw the publication of a policy paper entitled 'Proposals for tackling promoters and enablers of National Insurance Contributions avoidance schemes', which announces new clauses in the National Insurance Bill and the Finance Bill to extend the 2004 DOTAS legislation.

No doubt these new measures will supply HMRC with yet more targeted weapons to tackle this kind of abuse. However, they will do little to help the workers who are unwittingly caught up in such scams, often cheated of their employment rights, unable to make head nor tail of what is going on, and with little choice even if they could, particularly at a time when employment opportunities are scarce. Those who are in a position to make an informed choice may benefit from information such as the LITRG's factsheet on umbrella companies, produced in association with PRISM, which explains what to look out for and what to avoid. If, in addition to enacting ever more complex legislation, HMRC could work with charities, trade unions and large employers to make that kind of information more widely available, it could be even more effective in ultimately putting the promoters out of business.

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