Umbrella reform: the fog is clearing

Sam Cox reports on what the umbrella market can expect when new legislation comes into effect in April 2026

When the Government finally published draft legislation detailing tax reforms to the umbrella industry, it brought a long period of uncertainty to an end.

It was back in June 2023, when the previous Conservative administration was still in charge in Westminster, that a consultation had been launched on plans to tackle non-compliance in the umbrella company market.

Although still consisting of draft legislation and subject to change, the L-day measures – published on 21 July in the Draft Finance Bill 2025-2026 – provide some much-needed clarity.

Due to come into effect in April 2026, the reforms materially impact the relationships of parties in the contingent labour supply chain, bringing in a joint and several liability model. This measure will be introduced via a new chapter, Chapter 11, in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA).

Joint and several liability will mean multiple parties in a supply chain can be held liable for unpaid tax. The draft legislation confirms that focus will be primarily on the party closest contractually to the client.

The Bill also introduces new legislation aimed at purported umbrella companies. Under section 61Z1, HMRC specifically look to address businesses that adopt (with intent or otherwise) structures that would fall outside the definition of an umbrella company under the reforms

This provision means that, where other parties in the chain may reasonably suppose that a business is the employer of the worker and responsible for deduction of PAYE/NICs (as would be the case under a genuine umbrella model), that business would be considered a 'purported umbrella', regardless of whether they would otherwise meet the definition of an umbrella company, and the Chap 11 rules would apply.

The introduction of the legislation is part of a two-pronged approach from the government which will also see the introduction of further regulatory oversight, but the primary objective at this stage is to enable HMRC to reduce the 'tax gap' in the sector.

Reducing the tax gap

The Government's stated aim is to tackle non-compliance in order to close the tax gap by providing protection against the losses caused by fraudulent activity in the umbrella industry.

HMRC estimated that in the 2022-23 tax year it lost around £500 million to disguised renumeration schemes, often facilitated by non-compliant umbrella companies.

Furthermore, it is hoped the Bill will protect temporary workers from unexpected tax bills caused by the activities of such companies, as well as ensuring the temporary labour market operates on a level playing field by preventing compliant companies from being undercut.

Naturally, these measures have been largely welcomed by the compliant end of the umbrella market, who provide valuable and robust support to businesses with contingent labour requirements. That said, the legislation does create new liability, and a due diligence burden, on agencies and businesses who engage workers via umbrella companies.

Need for due diligence

The Draft Finance Bill 2025-2026 creates a direct liability for the most proximate party to the hiring organisation, or the hirer themselves if no agency in the chain. This means that where there is a PAYE/NIC shortfall as result of actions of an umbrella company (deliberate or otherwise), a strict liability is created for the agency (or hirer). There is no defence available to the agency (or hirer) made liable.

With this in mind, a renewed focus on due diligence will be needed in the coming months for any agency, or hirer, engaging workers via umbrella companies. The first step towards doing this will be to review labour supply chains – in complex cases, there can be multiple agencies and/or managed service providers and engagement models used for certain workers may be opaque – identifying where the legislation may apply (and to whom) is key.

Once usage of umbrella workers has been understood by a business, the next step is to establish whether the umbrella companies in the contract chain are operating compliantly. This can prove a challenge in what is (for the time being at least) a largely unregulated market.

While the Freelance & Contractor Services Association (FCSA) provide extremely valuable best practice guidance, and some important oversight and accreditation of umbrella companies, they are not armed with the same powers and reach as regulatory bodies like FCA, SRA, ICAEW, et al. A number of other organisations offer similar 'stamps of approval' suggesting umbrella compliance; however, examples of malfeasance by umbrella companies that hold accreditation from such organisations are not at all uncommon.

Ultimately, transparency will be the key to providing agencies and hirers with comfort. If an umbrella company can evidence PAYE/NICs calculations and payments throughout the chain, then the parties carrying liability for non-payment are able to satisfy themselves that deductions are being made and communicated correctly to all involved. Several 'payslip auditing' services have been established, which provide a good level of oversight. Similarly, software providers in the recruitment space may hold the key to 'opening the bonnet' and allowing agencies and hirers to undertake the much-needed due diligence.

The recruitment industry is a dynamic one, and businesses and advisers in the wider ecosystem offer reassurance that compliant operation can be maintained in the sector. This is certainly not the first time an HMRC reform has sparked mass change in the contingent labour space.

Go police yourselves…

The umbrella reforms follow a modus operandi that has been undeniably impactful for HMRC over the past two decades. With historic manpower issues, and enforcement in practice challenging for HMRC, legislation addressing tax avoidance in the contingent labour market has maintained a common thread – introducing new liabilities for parties in the contract chain, resulting from non-compliance of other parties.

Since 2007, this approach has been applied in the case of the MSC legislation, S44/Agency Regs, Public Sector Off Payroll, and Private Sector Off Payroll reforms. Each of these legislative updates sparked significant change in the recruitment space, driven by debt transfer protocols – and now via the mechanism of joint and several liability.

The message from HMRC is clear: when it comes to contingent labour, not only is the expectation that a business's own house is in order, they also need to ensure the neighbours' houses are in order, too. In truth, creating significant vested interest in the compliant operation of other parties has driven standards of compliance up across the market. That said, every new piece of legislation introduced, new 'innovative solutions' appear and, given today's wider economic environment, it is a certainty that more nefarious operators will be looking to gaps and loopholes to exploit in order to minimise labour costs.

We will watch with interest in the coming years how HMRC choose to utilise the new powers at their disposal under Chap 11.

In closing

Formal operational guidance will be issued before the legislation is introduced, and there will doubtless be more clarifications to come. But, for now, the uncertainty of the past two years has been lifted, giving the industry a chance to focus on how it prepares for the changes prior to next April's roll-out.

• Sam Cox, Commercial Services Director at Qdos