

## Recruiters' insistence that contractors use umbrella companies is breaching the law



Employment businesses who insist that contractors provide their services via an umbrella company, having determined them to be a 'deemed employee' under the Off-Payroll rules, are in breach of the law.

This is the situation according to Martyn Valentine, director of employment status specialists [The Law Place](#), who claims that the practice could fall foul of both the [Conduct of Employment Agencies and Employment Businesses Regulations 2003](#) and the [Employment Agencies Act 1973](#):

"Where an employment business finds work for a contractor under the condition that they work via a third party, the contractor is essentially paying out of their own pocket for work finding services," notes Valentine.

"This is certainly in breach of the Conduct Regulations, and it would be up to the magistrates to decide whether it is punishable under the Employment Agencies Act. The contractor would have a claim for damages against the employment business which may be commenced in the county court."

While a challenge against an employment business under the Conduct Regulations appears a promising means of recouping fees incurred by the contractor unfairly, being found in breach of the Employment Agencies Act could see an employment business face prosecution and consequent fines.

### Non-compliant recruiters fall foul of Conduct Regulations

Valentine's comments will be music to the ears of public sector contractors, many of whom have been subject to non-compliant practices by recruiters following the implementation of the Off-Payroll rules.

In addition to conducting blanket status assessments, many recruiters and public sector bodies (PSBs) have decided to force those deemed within scope of IR35 to work via umbrella companies. This negates the recruiters' tax processing requirements under the legislation.

"While blanket assessments alone fall foul of the 'reasonable care' requirement included within [Chapter 10 of the Income Tax \(Earnings and Pensions\) Act 2003](#), employment businesses are guilty of further unlawfulness by insisting that candidates work under umbrellas," comments Valentine.

He is referring to the [Conduct Regulations, regulation 5, which states](#): 'Neither an agency nor an employment business may make the provision to a work-seeker of work-finding services conditional upon the work-seeker using other services for which the Act does not prohibit the charging of a fee, whether provided by the agency or the employment business or by any person with whom the agency or employment

business is connected.'

Employment businesses may in some cases have legitimate reasons for requiring that contractors use a particular umbrella company, which are often concerned with ensuring high ethical standards are met. However, Valentine notes that this is a rarity in instances where an employment business is shown to be benefitting commercially from an arrangement, and where blanket assessments have been carried out.

## Recruiters could risk prosecution and fines

"Any breach of the Conduct Regulations is 'actionable', which means the losses suffered by a candidate could be recovered in court from the non-compliant employment business," continues Valentine. "In these instances, the contractor would make a claim against the employment business for the sum total of the fees paid for the umbrella's services, which can typically amount to around £1,000 per year for a contractor, plus statutory interest."

As the recent [Elbourn judgment](#) demonstrated, an employment rights claim at tribunal can prove an effective means of reversing an incorrect IR35 status assessment retrospectively, and so a claim under the Conduct Regulations could help recoup additional fees. However, a different course of action may prove more of a deterrent for non-compliant employment businesses.

"Where the Employment Agencies Act is concerned, it's a criminal offence to charge for work-finding services. Whether this is the case would be up to the magistrates' discretion, but it could result in prosecution and fines for offending employment businesses," explains Valentine.

Should a contractor wish to make a challenge by this means, Valentine adds that a complaint would first need to be made to the Employment Agencies Standards (EAS) inspectorate, which is the Government department responsible for enforcing the legislation. From there tribunal action could follow.

## How to avoid unwarranted deductions, while steering clear of court

Judicial action isn't an ideal scenario, and contractors who are being encouraged into similar arrangements can take pre-emptive measures to ensure that they don't have to go to court to restore parity.

"If found to be within scope of the Off-Payroll rules, where possible, contractors should make a stand and insist upon being supplied directly through the employment business as a Pay As You Earn (PAYE) temp or agency worker as is expected in law," comments Valentine.

As well as eliminating umbrella service charges from the outset, Valentine's recommended course of action could help contractors ensure that they receive what is owed to them under the [Agency Workers Regulations \(AWR\)](#) – contractors caught by Off-Payroll who have been engaged for 12 or more weeks will be eligible for full rights under the AWR, no matter what the employment business may say.

However, this tactic obviously isn't always going to work. In which case, contractors are reminded to conduct due diligence when approaching a contract, and be aware of unfavourable or suspicious contractual terms, as Valentine explains:

"A serious concern is that contractors caught by Off-Payroll are being denied rights under the AWR, potentially due to the drafting of clauses which may appear to negate the provision of such rights, but which themselves may not be legal."

## When not to opt out of the Conduct Regulations

Contractors need to ensure that, by signing the contract, they aren't agreeing to [opt out of the Conduct Regulations](#), as any subsequent proposed legal challenge under these rules will be a non-starter. Valentine adds that some less principled employment businesses compel contractors to opt out to delay payment and prevent contractors accepting offers of work directly with the client:

"In my view, an enforced opt-out could be declared void by the courts, unless there's a valid reason for doing so. There's absolutely no reason for a contractor to opt out of the Conduct Regulations unless they intend to operate outside of IR35 and have been advised accordingly," he explains. "The danger is that many contractors have already unwittingly done so."

Valentine says: "Whether contractors are negotiating an engagement or looking to pursue a claim against an unlawful employment business, professional help is always advised."

## What should agencies do?

Dave Chaplin, CEO of ContractorCalculator has sympathy for the agencies: "The agencies are being pulled in two directions on this. They want to satisfy their clients - who pay their bills - but also ensure their contractors are happy so that they can fulfill their clients resourcing requirements.

"Clients who decide to take a risk adverse approach to IR35 and insist on PAYE only arrangements are presenting a problem to agencies, because agencies cannot insist on routes that are in breach of the law, and most contractors will want to continue using their own limited companies which enables them to challenge any unfair assessment of their IR35 status.

"The only 'no-challenge' option available for clients and agencies for 'inside IR35' contractors seems to be insisting on PAYE only, at no extra cost to the contractor, with the client increasing the rate they are prepared to pay to continue to attract the most talented contractors.

"The PAYE option can of course be outsourced to an umbrella company, but the contractor should end up getting paid a gross salary that aligns with the rate they were offered under standard PAYE arrangements. This will mean clients and agencies accounting for all employment costs (employers NI, app levy, holiday pay) on top of the PAYE rate agreed with the contractor.

"A PAYE-driven approach would also help drive out the tax avoidance schemes which proliferated in the market after April 2017, which wear the name of 'umbrella company' but which are non-compliant.

"The alternative approach, and perhaps easiest, is to process deemed payments, [as per the legislation](#), and let contractors carry on using their limited companies. Whilst there were no providers who could do this in April 2017, there are now several who can help agencies do this."

Published: Thursday, October 25, 2018

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