

Umbrellas, HMRC, and dispensation agreements

[This article was written by Rob Crossland, the Managing Director of the Umbrella Company Parasol Ltd]

What is an umbrella company?

There are no national guidelines from a HMRC perspective that defines what an "employment business" is. Each arrangement between an [umbrella company](#) and the Revenue is defined locally and the Revenue treats that as they would any other business. So the term "umbrella company" can encompass many forms of employee management services (another term used).

Employee management services range from companies deducting tax and NI at source and allowing some business expenses (vanilla umbrella), the now "outlawed" composite schemes (providing shares in a company structure to allow dividends), offshore schemes, employee benefit trusts based schemes and any combination of the above. Similarly the complexity of the service on offer differs widely with some management structures offering nothing more than a simple payments allocation service to workers bank accounts whereas others have developed a far more in-depth service covering such areas as employment contracts, extendable HR functions, comprehensive insurances and employment rights.

[Editors note: Composite schemes are no longer a viable option due to the [Managed Service Company Legislation](#) introduced in the 2007 budget. Other non vanilla schemes have been subject to attack by the Revenue in previous Budgets, making the PAYE Umbrella the only viable Umbrella option for contractors.]

Many of the more elaborate schemes purport to help "avoid" [IR35](#) and this of course will have interested the Revenue (particularly as HMRC has lost most if not all IR35 cases brought to court).

How Does HMRC View Umbrella Companies?

Prior to the 2004 budget HMRC did not have a national policy for handling the variety of guises that the term umbrella company describes. The new legislation, when law, will address the need to "report" tax avoidance schemes and some forms of umbrella company operations will need to work within those laws.

However, the situation still exists where any new business can approach HMRC locally to arrange an expense policy, PAYE registration, lay out a basic business operation and set up as a form of "umbrella". HMRC are certainly aware of what an umbrella company is but they do allow quite a large measure of variation for even the vanilla flavours of Umbrella Company.

The reporting of "tax avoidance" schemes would seem to partly address some of the more dubious operations. The other question will be based around whether HMRC see these types of businesses as a good way of collecting Tax/NI or simply a way of avoiding paying PAYE/NI. Perhaps one should argue that the new legislation tackles schemes that purport to provide high net pay returns whilst allowing the safer versions to continue collecting good levels of Tax/NI for HMRC and at the same time offer freelance workers a legitimate and convenient trading structure.

Does HMRC Consider Umbrella Companies to be Tax Avoidance Schemes?

The imposition of new legislation almost certainly addresses certain forms of Umbrella company operations. The accountants, advisors and owners of those businesses will need to be sure that their form of operation is not an avoidance scheme.

The rub will be in marketing the service in an attractive way (to contractors) whilst trying to convince HMRC that it is legally sound in the form of its operation. Again, the term "umbrella company" is used to describe a variety of services which can be at both ends of the avoidance rulings.

So in one form, should a vanilla umbrella allowing genuine business expenses with proper audit procedures be viewed as an avoidance scheme? If that umbrella business has satisfied HMRC (locally) that it has a genuine business modus operandi then how can it be avoidance? The problem with that argument is then based on the fact that the more "generous" schemes will use the same arguments locally to also attempt to prove the case.

Again, we should not underestimate HMRC being aware of these discrepancies and it would seem the avoidance legislation will attempt to address this.

What is a Dispensation Agreement?

Every business would normally be required to complete P11D's for each and every employee in relation to expenses claimed. A dispensation is simply a way of reducing paperwork as the granting of a dispensation relieves the employer (umbrella) from having to complete P11D or P9D's. It can further simplify the process for employees as they do not have to include details of the expenses and benefits covered by the dispensation in their tax returns. Nor are the expenses and benefits included in either their tax assessments or PAYE codes.

These factors make a dispensation attractive for umbrella companies; it simplifies the administration (passing a cost saving back to the individual) and is an attractive sales pitch. What a dispensation does not allow is for the individual nor the umbrella company to allow expense allowances when no real expenditure has taken place. Furthermore it does not "guarantee" that the individual should not have receipts for business expenditure. Some umbrella

companies (and again the term is used to cover a multitude of operational stances) would seem to stretch the dispensation point to the absolute limit.

A dispensation is simply a way of reducing administration and should not be viewed as a way to claim carte blanche on all types of un-receipted expenses.

Are Dispensations the Same for all Umbrellas?

No. Each dispensation is granted locally and the amounts and forms of dispensation vary according to each local agreement. There is no level playing field for this type of thing and it is something that HMRC should address since it has given some scheme operators (with a more "cavalier attitude" to compliance) the opportunity to stretch the boundaries too far, leading to potential problems down the line. It is also worth remembering that it is the Contractor that will face the unpaid tax liability should HMRC decide expenses have been falsely claimed.

Are you Sure it is Okay to Claim Without Receipts?

No! An individual cannot claim for an un-receipted business expense that they did not genuinely incur and can not evidence. The umbrella organization must be auditing that expenses are genuine and at least should be asking for receipts for a reasonable sample of individuals.

Those same individuals should also be aware that ultimately the liability of any underpaid tax will reside with them. So, if an umbrella scheme purports extremely generous expense allowances, no receipts required (ever) and uses this as a main "feature" then the individual should be very careful.

Even if those organisations can display HMRC dispensation paperwork, it does not absolve them or the individual from claiming expenses in the correct and audited way. In simple terms, receipts are your "insurance"

Could I get Chased Up Later?

Yes. There are previous cases where HMRC has settled with multiple individuals that have been employed via an umbrella that has allowed expenses incorrectly.

If the umbrella company is working in a professional and genuine manner then should not be an issue. Remember the old adage, if it seems too good to be true then it probably is.

The Future

The umbrella company is here to stay. Since the introduction of IR35 and recent legislation this form of working will continue to flourish. The form of how individuals are employed and work will continue to fuel this.

Those umbrella companies that provide a sensible level of return, good service and are clearly not purporting to be avoidance will survive and grow. There are still many benefits for many people of working this way and this is unlikely to change.

A few rogue companies will fall by the way side and the danger is that there association with the term umbrella company will sully the reputation of the genuine operators. Perhaps a new form of umbrella company term is needed...suggestions please.

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