

# The Great Payroll Scandal



**A Report for UCATT**

By Jamie Elliott

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# FOREWORD



The nature of the construction industry means that workers frequently have to change sites and employers throughout their working lives. Even the largest project is only likely to last for three years and very few workers will be on that site throughout that time.

Therefore, by its nature construction is a transitory industry. Yet these problems are made far worse by the unique way in which the UK construction industry operates. Roughly half of construction workers are officially classified as self-employed, a level of self-employment which far outstrips other major domestic industries. The level of self-employment in construction is unique to the United Kingdom; no other major industrialised country has a self-employment level anything like as high as ours.

A large percentage of self-employment in construction is false. Workers have all the attributes of an employee but none of the rights. A falsely self-employed worker does not receive holiday pay, sick pay, does not have a pension and can be sacked at a moment's notice.

The major winners from this arrangement are the employers who avoid paying national insurance contributions for falsely self-employed workers, while also making massive savings on holiday pay, sick pay and pension contributions. As this report demonstrates the cost to the Exchequer in false self-employment is approaching £2 billion per annum.

In recent years it has become increasingly apparent that certifying and verifying false self-employment in the construction industry has in itself become a multi-million pound business. Construction contractors are putting ever more complex structures between themselves and the workers they in reality employ.

Jamie Elliot's report shines a light into these dark and confusing practices and demonstrates how they operate. It also demonstrates that while the level of sophistication and complexity of schemes to indemnify false self-employment are growing, the HMRC is decreasing its attempts to tackle the problem, either through lack of resources or lack of political will.

this report focuses on the construction industry where these problems are at their most extreme. However it would be wrong not to recognise that these practices are sadly spreading into other industries, especially those where there is a rapid turnover of temporary workers.

With the publication of this comprehensive exposé, there is no longer any excuse for the Government, the HMRC or any major political party to claim that they don't understand the problem of false self-employment and payroll companies.

I hope that this excellent report is used to lobby MPs and starts changing the construction industry for the better. In the 21<sup>st</sup> century it is essential that workers are treated fairly and decently and that employers are no longer able to artificially boost their profits through the long-term and systematic denial of workers' rights.

A handwritten signature in black ink that reads "Steve Murphy". The signature is written in a cursive, slightly slanted style.

**Steve Murphy**, *General Secretary UCATT*

# The Great Payroll Scandal

## The problem

An employment scandal costing hundreds of millions in lost tax revenue, and depriving hundreds of thousands of construction workers of their employment rights, is taking place across the UK. But little is being done to stop it.

The scandal involves payroll companies who help construction firms switch their staff from the status of employee to self-employed subcontractor, even though many of these individuals are not genuinely self-employed.

Once switched to self-employment, the individuals concerned are stripped of their entitlement to holiday pay, sick pay, a company pension and the national minimum wage.

Some payroll companies are also using tax relief claimed against workers' expenses to fund Employers' National Insurance and pay their own fees.

Many of these activities are in clear breach of government tax rules, but are openly promoted by payroll companies on their websites and in promotional literature.

Despite growing evidence of the role these companies are playing in helping construction firms deprive workers of their employment rights, there is little sign of government action to crack down on these practices. In fact the opposite appears to be happening – figures uncovered by UCATT reveal that the number of employer compliance reviews about employment status issues carried out by HMRC in the last three years has fallen dramatically<sup>1</sup>.

## Big profits to be had

Employers benefit from switching their staff to self-employed status because they no longer have to pay Employers' National Insurance, holiday pay or other benefits. They can also hire and fire their former employees at will.

But the real winners are the payroll companies. They are making millions by levying fees for their services - fees which are sometimes paid for not by the employer, but instead are deducted from the pay of the supposedly 'self-employed' subcontractor.

## Undercover operation

UCATT has campaigned against the activities of some payroll companies, and the employers who use them, for a number of years. But hard evidence has been difficult

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<sup>1</sup> 'The number of employer compliance reviews opened where status was shown as a risk in the construction industry is: 2009/10 = 1205, 2010/11 = 454, 2011/12 = 433.' HMRC response to UCATT Freedom of Information Request: 30.08.12.

to come by - the payroll companies have consistently maintained that the workers they help convert to self-employed status are genuinely working for themselves.

So to discover more about how these companies are operating, UCATT set up a fake building company – Fairbrother Builders – earlier this year, and then contacted a number of payroll companies, posing as a family construction firm with 15 employees.

We asked the companies how they could help Fairbrother Builders save money.

Hudson Contract, the UK’s biggest payroll company, made no attempt to conceal the nature of the service it was offering.

‘We can save you money, 20% of your labour costs, by reclassifying PAYE staff, paying them through CIS,’ Hudson wrote in an introductory letter<sup>2</sup> to Fairbrother Builders. (CIS is a construction industry tax scheme for self-employed people<sup>3</sup>).

‘Self Employed operatives, paid under CIS deduction through Hudson are not entitled to holiday pay, redundancy or notice,’ the letter said. ‘We are helping companies to move their PAYE labour over to CIS...Last year this saved our clients over £25M in Employers NIC, placing tax and employment law liabilities with us.’

### **Little needs to change on the ground**

A majority of the payroll companies we contacted as Fairbrother Builders told us we could switch our workforce to self-employed status without making any material changes to the way our firm operated. Our workforce could continue working solely for Fairbrother Builders full time, and we could continue to direct their work as we did now.

“Really, the relationship you now have with the boys doesn’t change in any way, shape or form,” a regional account manager from Hudson Contract told us when we telephoned the company, posing as Fairbrother Builders. However, the account manager also made it clear that our workers would need to freely choose to switch to self-employment. In addition, he explained that as self-employed freelance operatives, they would be free to work for anyone else they liked.

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<sup>2</sup> See appendix for copy of Hudson letter to Fairbrother Builders.

<sup>3</sup> CIS (Construction Industry Scheme) is a tax arrangement unique to the construction industry which allows construction firms to make a flat rate income tax deduction from the pay of self-employed contractors registered with the scheme at source.

### **How false self-employment works**

Payroll companies are offering employers what they claim is a low risk way of converting their workforce from employee status (where tax and National Insurance is paid directly by the employer via PAYE) to self-employed status.

The employer tells the workforce he or she would like them to switch to self-employment. As an incentive, workers are sometimes offered a small increase in their hourly pay, which rarely compensates for lost holiday pay, sick pay and other benefits.

The employee is then invited to apply (sometimes with help from the payroll company) for a Unique Tax Reference number and self-employed status under the Construction Industry Scheme (CIS) which allows companies to make deductions for tax from the pay of self-employed sub-contractors at source. (The CIS scheme is unique to the construction industry and has been heavily criticised for encouraging the practice of false self-employment.)

### **Carefully worded contracts**

The worker signs a contract with the payroll company which says that he or she is self-employed and, crucially, is now being engaged by the payroll company, not by the construction business he or she continues to carry out work for.

Once the contract is signed, the individual, according to the payroll companies, no longer has a legal relationship with the construction business they are carrying out work for (which the payroll companies refer to as 'the client'). Instead, the former worker has become a self-employed sub-contractor of the payroll company itself.

Hudson Contract makes this very clear in the contract it asks people switching from PAYE to becoming self-employed (or 'freelance operatives' as it describes them) to sign.

The freelance operative, the contract says, 'has no contract of any type whatsoever with the Client,' and, 'he neither has nor shall make any contractual claim of any type against the client.'

But the Hudson Contract document also makes very clear that the new relationship between the freelance operative and the payroll company has little to do with the way work is actually agreed on the ground between the self-employed person and the construction business they are doing work for. Only the legal question of who is contracting with whom changes.

'The terms upon which that labour shall be supplied shall be negotiated directly between the Freelance Operative and the Client,' the contract says. But it adds:

‘Upon the conclusion of those negotiations, Hudson will step into the shoes of the Client and contract with the Freelance Operative on the terms negotiated.’

### **Costs sometimes met by workers**

The payroll company’s fee is sometimes deducted from the freelance operative’s wages.

‘Although the fee is charged to you – the client – it can be offset against an operative’s earnings,’ the Hudson Contract website tells employers.

### **The rules are clear**

Despite the confidence displayed by Hudson Contract and other payroll companies we contacted, the fact remains that in employment law, it is what a worker actually does, not what a contract says, that determines his or her employment status.

HMRC makes it plain that anyone who works continuously and uniquely for a single firm is not genuinely self-employed. To claim self-employed status, HMRC guidance says, an individual must work for a number of different people, decide what work to do, how and when they work, risk their own money, and be obliged to correct unsatisfactory work in their own time and at their own expense.

### **Court judgement gave boost to Hudson Contract**

HMRC challenged Hudson Contract in the High Court in 2007. It sought to persuade the court that, despite what was stated in the Hudson contract, there was an implied relationship between the ‘client’ (the construction company) and the ‘freelance operative’ because of the reality of the relationship between them.

But the court ruled against HMRC, saying that at the time they sign the contract, both Hudson Contract and the former worker (now freelance operative) intend the contract to operate as it states. However, the court also acknowledged that after the contract was signed, a contract of employment could be implied if circumstances changed.

Hudson Contract refers frequently to this and other court judgements in its promotional material, claiming that these rulings offer employers protection from potential action by HMRC.

‘Say goodbye to HMRC status issues and employment tribunal challenges,’ the company’s website home page says, adding elsewhere: ‘No other company is able to offer you the same level of protection.’

On a webpage entitled Your Tax Guarantee, the company says: ‘We have defended our business model through two Tax Commissioner hearings and a High Court Appeal. Our experience is that Hudson Contract clients do not attract legal arguments or unwanted attention from HMRC.’

### **Protection from prosecution**

When we contacted Hudson Contract posing as Fairbrother Builders, we were left in no doubt that an important part of what the company was offering, was protection from prosecution by HMRC.

“In a way they are not really self-employed because they are working just for us,” we said to a Hudson Contract Regional Account Manager about the actual status of our workers, were they to agree to become ‘freelance operatives’ and sign the Hudson contract.

“Correct,” the Account Manager replied. “Hudson takes the risk on. We eliminate the risk for you by our contract because it’s been through the judicial process and we’ve won our case. And yes, the guys are working for you for as long as you want them to work for you really, and there’s nothing the revenue can do about it.”

### **Employment agencies**

Payroll companies are widely used by employment agencies providing staff to the construction sector. UCATT frequently comes across individuals recruited by such agencies who have been given little choice about accepting self-employed status or payment via an umbrella company; they either go along with the terms laid down by the employment agency or do not get the work.

### **Workers kept in the dark**

Some UCATT members have even reported being switched to self-employment without their knowledge.

Darren (not his real name), was taken on by an employment agency in 2010 to work as a labourer on a big hospital building project in Scotland for which he was paid slightly less than £8 per hour.

“The agency took my bank details and told me that the payroll company [not one of those referred to in this report] who were paying me would deduct £22 per week from my wages for processing my pay,” he says. “I didn’t get holiday pay or sick pay but no one had mentioned self-employment.”

It was almost a year later that Darren found out from other workers on the site that he was in fact being treated as self-employed. He insists he had not registered himself as self-employed or joined the CIS scheme.

“The wage slips were really complicated and I couldn’t understand them,” he adds.

Once he realised what was happening, Darren called the agency to complain. The agency boss came to see him and agreed to switch him to PAYE straight away.

“My hourly rate stayed the same,” Darren says, “but it was much better once I was on PAYE because if I was sick, or needed time off for a holiday, I could take it.”

Another UCATT member, Peter (not his real name), was less fortunate. He and a friend were each paid £10 per hour as labourers by a Yorkshire construction company which they joined in February 2009.

“It was only the week after we started that we found out we weren’t being paid directly and were being treated as self-employed,” Peter says. “We had given the company our NI number, bank account details, but at no point were we asked if we were self-employed or whether we wanted to be.”

Like Darren, Peter and his friend were issued with timesheets, which were signed each week by the construction company and which the pair then had to send to a payroll company [again, not one of those referred to elsewhere in this report].

“The payroll company deducted £12.50 each from our wages every week for paying us,” Peter says. “I wasn’t happy about this, and asked to go on the books, but the boss said ‘I’d love to but I can’t’”.

Peter had joined the company at the height of the recession.

“I felt I was being used, and treated like a second class citizen,” he says. “But what could I do? You either take it or go on the dole. I had a mortgage and I had a family to feed, so I had to put up with it.”

### **Millions in lost revenue**

The activities of some payroll companies are costing the government millions of pounds in lost tax revenue.

Hudson Contract, for instance, prominently posts on its website home page the ever increasing number of individuals it has signed up as ‘freelance operatives’ – 111,039 as of August 13 2012 – and the figure is increasing by hundreds every week.

Of course, some of these freelance operatives are genuinely self-employed. But each of them, Hudson Contract told us in a phone conversation when we posed as Fairbrother Builders, can claim a tax saving against expenses – for things like equipment and travel costs - of between £700 and £1400 per year. This is a saving not available to PAYE workers.

If we add together the estimated tax saved against expenses of all the Hudson Contract ‘freelance operatives’ it comes to in excess of £114m annually<sup>4</sup> (although some of these tax savings against expenses will be claimed by operatives who are genuinely self-employed). In addition, a number of these ‘freelance operatives’ will be working for employers who were previously paying Employers’ National Insurance, currently 13.8% of gross pay. So the total potential loss to the Treasury is considerable.

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<sup>4</sup> Assuming a tax saving against expenses per ‘freelance operative’ engaged by Hudson Contract of £1050 per annum.

## **A widespread problem**

Many other payroll companies operate in a similar way to Hudson Contract.

Another large payroll company we contacted told us that switching our staff to self-employment could save Fairbrother Builders between 20% and 25% of its current labour costs.

This company also stressed that using its services to help switch workers to self-employment would provide us with protection from HMRC.

“What you will be covered for with ourselves is if the Inland Revenue came knocking on your door saying hello we want to do a PAYE audit, and they said look ten of these fifteen men here actually should be employed by you, they shouldn’t be self-employed. We indemnify you against that, once you sign up with us,” the company’s representative said. “You would just point the Inland Revenue in our direction and say, look, they are no longer my responsibility.”

He added: “That [protecting companies from HMRC], is the huge part of what we do and all our competitors do.”

But not all payroll companies, he warned, could be trusted to shield us from prosecution.

“There are a lot of guys out there who say they’ll do it, but when push comes to shove and they are put under it by the Inland Revenue they will fold, and then come back to you...So what I’m saying to you is, just be careful.”

When we asked a representative of another large payroll company if we would be able to continue to direct our workforce in the same way as we do now once they switched to self-employment, we were again reassured that we would. As long as we specified what we expected of self-employed staff in their contract, little needed to change.

“You can still tell them where to be and what to do, but they are employed by themselves,” the representative said. “What you need to have a look at is drawing up a sub-contractor contract for them all to sign, outlining that they know they are self-employed and put in the contract any rules and procedures you want to put in place.”

Could we still tell our staff to work from eight to five?

“Yes that’s fine. Any of the procedures you’ve now got in place now, you have to put that in there [in the contract], as long as you highlight the fact they are self-employed.”

“So it doesn’t matter that they are not working for other people, and that they are just working for us,” we asked.

“No, that’s not a problem, that’s fine,” the representative said.

### **Rules are easy to circumvent**

HMRC guidelines say that one of the things that shows whether someone is self-employed is if ‘they provide the main items of equipment they need to do their job, not just the small tools that many employees provide for themselves.’ This includes vehicles.

But when we told another payroll company that some of our workers did not own vehicles and would need to continue using ours, they suggested a simple way round this problem. We could simply hire our vehicles to our self-employed workers and pay them extra to compensate them for the hire cost. In this way everyone could continue to use the company vehicles as they did now.

“I have a company who is in exactly the same position as you in London,” the company’s representative said. “Because they have gone with us [switched their employees to self-employed status], he has to charge them for the van. But what he does then, is he pays them a bigger rate so it takes care of it.”

To double check, we asked: “So in fact, we can still all use the van if we need to?”

“Yes,” the company representative replied.

### **Umbrella companies and the ‘travel and subsistence’ rip-off**

Payroll companies offer employers an alternative cost saving route to switching their workers to self-employed status: umbrella companies. This option allows construction firms to avoid paying Employers’ National Insurance by switching their workers to employment by an ‘umbrella company’ operated by a payroll company. The worker remains a worker paid via PAYE, but now is employed by the umbrella company under an ‘overarching contract’ instead of by the construction company he or she is actually carrying out work for.

The cost saving to employers is achieved thanks to a tax dodge which involves using tax relief on employees’ travel and subsistence expenses to pay Employers’ National Insurance.

### **Workers’ tax relief used to save employers money**

Instead of passing on tax relief on expenses to the individual worker entitled to it, the umbrella company (run by a payroll company) uses the lion’s share of this sum to pay Employers’ National Insurance and its own fees. So the construction company

which transfers its workers to an umbrella company no longer has to pay Employers' National Insurance. This adds up to a big saving; Employers' National Insurance is currently 13.8% of an employee's pay.

The dodge is possible because of a tax rule which says that employees paid via PAYE whose work involves carrying out a series of short-term contracts at a temporary workplace can claim tax relief against travel and subsistence expenses paid to them by their employer. The 'overarching contracts' offered by umbrella companies are designed for people who work in this way.

In reality, however, many of the employees who are switched by their employers to employment by an umbrella company are not really carrying out a series of short-term contracts at all. They are still working uniquely for the same construction company they have been working for all along. Instead of being paid directly by that construction company, the worker is now paid by an umbrella company, making it look as though he or she is carrying out a series of temporary contracts. And because the worker appears to be carrying out temporary contracts, he or she also appears to be entitled to tax relief on travel and subsistence expenses.

Moreover, some payroll companies are not actually paying travel and subsistence expenses to these employees at all. Instead they are saying that because the worker has paid expenses themselves, travelling to a 'temporary workplace', then this portion of the employee's wage does not need to be subject to tax and National Insurance. These schemes have been termed 'Pay Day by Pay Day tax relief models'.

HMRC has said unequivocally that these models are not compliant with tax law.

Whilst an employee incurring expenses can him or herself make a claim to HMRC at the end of the tax year, HMRC spelt out in a recent statement that 'the granting of tax relief and National Insurance relief by an employer each pay day is **not** compliant with tax and Social Security legislation.'<sup>5</sup>

This is because, as HMRC said in a very similar statement in July 2011, an employer can only grant tax and National Insurance relief on expenses which are paid on top of an employee's wage. Or as the HMRC statement puts it, when 'the employer **separately and distinctly** pays or reimburses an additional amount in respect of certain travelling expenses.'<sup>6</sup>

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<sup>5</sup> HMRC statement: 'Pay Day by Pay Day Tax Relief Models and Dispensations' August 2012  
<http://www.hmrc.gov.uk/news/news290812.htm>

<sup>6</sup> HMRC statement: 'Pay Day by Pay Day Tax Relief Models and Dispensations' July 2011  
<http://www.hmrc.gov.uk/news/relief-models.htm>

Despite these very clear statements, the rules are still being flouted.

A chart sent to us by one of the payroll companies we contacted as Fairbrother Builders showed that this company was continuing to operate a pay day by pay day tax relief model.

The chart gives an example of an individual construction worker earning £8.00 per hour when employed directly, who would see just an extra £2.62 per week once he had been transferred to employment by the umbrella company. This was because the payroll company would be claiming tax relief on weekly travel and subsistence expenses of £50 for that individual, a tax saving worth approximately £10 per week (i.e. 20% of £50). But the worker would only receive £2.62 of this tax relief, whilst the rest of the tax saving would be used to pay Employers' National Insurance and the payroll company's own fee.

### **A tax regime open to abuse**

HMRC makes it easy for many payroll companies to operate in this way by giving them a special dispensation which means they do not have to subject the payment of expenses (as long as these are paid in addition to the national minimum wage) to tax and National Insurance.

An important part of the business model of many payroll companies rests on this 'dispensation'. Without it they would not be able to deprive workers of the tax relief on expenses which is rightfully theirs, and then use that tax relief to pay Employers' National Insurance and their own fees.

UCATT is calling for this dispensation to be abolished.

### **Not all payroll companies are the same**

Some payroll companies we contacted took a very different approach to employment status issues.

Liberty Bishop Contractor Services Limited, for instance, was adamant that for Fairbrother Builders, switching our staff to either an umbrella company, or to self-employment under the CIS scheme, was wholly inappropriate.

"An umbrella solution is only designed for contract workers - it's not something that is designed for permanent employees," a Liberty Bishop staff member told our researcher.

This, he explained, was because umbrella companies were suitable for contractors carrying out temporary contracts who could then claim tax relief on expenses.

“This service is not relevant to a permanent employee, because a permanent employee isn’t entitled to these tax incentives,” he said.

When asked about helping us switch our staff to self-employment under the CIS scheme, he again told us unequivocally that the self-employment route was not suitable for our workers.

“Because they are permanent employees,” he said, “they are not entitled to any of the incentives contractors would be.”

### **False self-employment costs Treasury almost £2bn a year**

Businesses using self-employed staff are not liable for Employers’ National Insurance, resulting in a huge loss to the Treasury.

The latest estimate of the number of falsely self-employed construction workers in the UK puts the figure at between 375,750 and 433,000<sup>7</sup>. The average gross weekly pay of a construction worker is £555<sup>8</sup>, and employers’ National Insurance is currently 13.8% of gross pay. So the loss to the government in uncollected Employers’ National Insurance due to false self-employment in the construction industry amounts to approximately £1.2 billion per year<sup>9</sup> (assuming 400,000 falsely self-employed workers).

The government is hit by a further loss because self-employed people pay a lower rate of National Insurance than those who are employed – self-employed people pay 9% of their gross earnings, whilst employed people pay 12%. Assuming again 400,000 falsely self-employed workers, this adds up to an additional annual loss to the Treasury of almost £200m<sup>10</sup>.

It has also been estimated that self-employed sub-contractors each benefit from tax relief on expenses worth approximately £1,300 per year<sup>11</sup>, which when multiplied by the estimated number of falsely self-employed sub-contractors adds up to a further annual loss to the Treasury of about £520m. Add to this the £1.2bn in lost Employers’ National Insurance, and the lower employee National Insurance contributions, and the annual cost to the exchequer of false self-employment is approaching £2bn.

<sup>7</sup> The Evasion Economy - False Self-employment in the UK Construction Industry. University of Essex study commissioned by UCATT, 2010

<sup>8</sup> Office for National Statistics 2011 Labour Force Survey: ‘Average gross weekly earnings of full-time employees by industry.’

<sup>9</sup> £411 (average weekly construction industry wage of £555 minus £144 exempt from Employers’ National Insurance) x 52 weeks = £21,372 per annum liable for Employers’ National Insurance (currently 13.8% of gross pay). 13.8% of £21,372 = £2949 x 400,000 (estimated number of falsely self-employed construction workers) = **£1,179,600,000** in lost revenue.

<sup>10</sup> Construction worker earning £555 per week: difference in annual employee National Insurance contribution between self-employed rate (9%) and employee rate (12%) = £495.17 per year. £495.17 x 400,000 (estimated number of falsely self-employed workers) = **£198,068,000** in lost revenue.

<sup>11</sup> The Evasion Economy - False Self-employment in the UK Construction Industry. University of Essex study commissioned by UCATT, 2010.

### **A licence to print money**

Despite the downturn in the construction industry, payroll companies are making big profits by helping firms switch workers to false self-employment, and these profits are increasing fast as more and more firms sign up for their services.

Hudson Contract saw its turnover increase by 21% in 2011/12 compared to the previous year, helping the company make a pre-tax profit of £4.3m.

### **CIS makes false-self employment easy**

The construction sector is subject to a unique tax regime – the Construction Industry Scheme (CIS) - which allows firms to make flat rate deductions for payment of income tax from the pay of self-employed contractors registered with the scheme at source. The CIS scheme was intended to simplify payment of tax for contractors working for a range of clients, and to maximise tax collection for government. But the CIS scheme has made it very easy for employers, and payroll companies, to switch workers who are not genuinely self-employed to self-employed status.

Figures obtained from HMRC by UCATT show a significant increase in the number of workers joining the CIS scheme. 770,000 sole traders were paid via the scheme in 2011/12, up from 760,000 the previous year, and 740,000 in 2009/10.

The rise in sole traders using the CIS scheme came at a time when the overall construction workforce has been falling. The Office of National Statistics records that construction had a workforce of 2,079 million in 2009/10, this fell to 2.024 million in 2010/11 and only rose to 2.031 million in 2011/12.

This demonstrates that the increase in false self-employment has increased while the construction industry has been in recession.

### **A failure of enforcement**

Avoiding Employers' National Insurance, holiday pay and other benefits by switching workers from the status of employee to false self-employment is against the law. But the fast growing activities and profits of payroll companies suggest that the rules prohibiting false-employment are not being enforced adequately.

Figures obtained by UCATT bear this out. The number of employer compliance reviews carried out by HMRC inspectors into employment status issues in the construction industry has almost halved over four years. In both 2008/09 and

2009/10 over a thousand such reviews were carried out. But in 2010/11 the figure slumped to 454 reviews, and in 2011/12 it fell even lower, to just 433.<sup>12</sup>

Not surprising then that UCATT's undercover research has demonstrated that payroll companies have little fear of investigation or prosecution by HMRC.

An additional reason for the confidence displayed by payroll companies may be the fact that HMRC sets the bar for criminal investigation very high.

'It is HMRC's policy to deal with fraud by use of the cost effective Civil Investigation of Fraud (CIF) procedures, wherever appropriate,' its Criminal Investigation Policy states. 'Criminal Investigation will be reserved for cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate.'

The policy goes on to list circumstances in which a criminal investigation may be brought, including cases of organised criminal gangs attacking the tax system and where money laundering is suspected.

### **Legitimate employers losing out**

The failure to crack down on the activities of payroll companies is creating an unlevel playing field where legitimate construction employers are undercut in the marketplace.

"Some payroll companies encourage people to start from a position of unfair competition by offering some employers the chance to avoid overheads of National Insurance," says Gray Rigge of the National Access & Scaffolding Confederation. "Employers who directly employ invest in training and equipment, but companies that use payroll companies are able to poach these employees by offering slightly higher net pay, but actually worse conditions overall."

Rigge believes a more robust approach from HMRC is needed.

"The problem is that the law is not tested by HMRC bringing prosecutions. They seem to take the view it's more trouble than it's worth," he says.

### **Auto-enrolment pensions could make matters worse**

Auto-enrolment pensions (where employers are obliged to contribute towards the pension of all workers unless they opt out), which came into effect in October 2012, could inadvertently encourage false self-employment.

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<sup>12</sup> HMRC response to UCATT Freedom of Information Request: 30.08.12. 'The number of employer compliance reviews opened where status was shown as a risk in the construction industry is: 2008/09 = 1049, 2009/10 = 1205, 2010/11 = 454, 2011/12 = 433.'

Self-employed people are not included in the auto-enrolment pension plans, so it will be tempting for employers faced with the additional cost of contributing to a pension for their workers, to instead encourage them to switch to self-employed status.

Should auto-enrolment pensions result in more workers being switched to self-employed status, this will inevitably place a greater strain on public resources; people who have not been enrolled in a pension scheme are more likely, once they retire, to need housing benefit and other forms of state support.

### **All labour providers should be licensed**

Payroll companies which provide labour in the agriculture, food processing and packaging, and shellfish sectors are licensed by the Gangmasters Licensing Authority (GLA).

But the construction sector is not covered by the GLA, despite calls from UCATT, the TUC and many others for its remit to be widened. This means payroll companies who operate in the construction sector are not subject to the rigorous checks which protect workers in those sectors licensed by the GLA.

Importantly, the GLA carries out on the ground inspections to check the employment status of workers engaged by the labour providers it licences. These checks include interviews with a sample of workers to 'explore the reality of the employment relationship, and look at the way that the workers carry out their duties and the way in which they are treated'<sup>13</sup>.

The GLA places great emphasis on establishing whether or not workers are genuinely self-employed and asks a series of questions aimed at establishing the reality of their employment status.

It also critically examines tax relief schemes to ensure that they are fully compliant with tax and national minimum wage legislation. In addition, the GLA considers whether a fee for the provision of a tax relief scheme breaches its Licensing Standards.

Between March 2011 and April 2012, 33 labour providers had their licences revoked as a result of infringements uncovered during inspections.

UCATT believes all workers should enjoy the protection extended to those working in the sectors currently covered by the GLA licensing regime.

### **Construction staff should automatically be deemed to be employed**

UCATT is highly supportive of a proposal put out for consultation in 2009 by the last government which suggested that workers be automatically deemed to be employed (as opposed to self-employed) unless they meet strict criteria.

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<sup>13</sup> How the GLA tests Employment Status – GLA Brief, Issue 18, Jan 2012.

Under these 'deeming' proposals, a worker would no longer be able to simply declare him or herself to be self-employed as they can now, but would have to actively demonstrate that they were not directly employed.

UCATT believes that to be deemed self-employed, an individual working in construction should be required to demonstrate that they meet **at least two** of the following criteria:

- They provide plant and equipment needed to carry out their work
- They provide all materials needed to carry out their work
- They provide other workers to assist with their work
- They are registered for VAT.

Making direct employment the default position for construction workers, and requiring those who wish to be self-employed to prove they meet strict criteria, would make it much harder for firms to switch staff to false self-employment. It would also guard against some of the worst practices highlighted in this report, such as workers being switched to self-employment without their knowledge.

## **Recommendations**

- CIS (Construction Industry Scheme) should be abolished. Instead, a single self-employed tax status should be established in which all self-employed are paid gross, and are responsible for their own tax affairs.
- Workers in the construction sector should automatically be deemed to be directly employed unless they can demonstrate they meet strict criteria required to qualify for self-employment (criteria detailed in this report).
- HMRC should abolish the special dispensation it gives some payroll companies which exempts them from the requirement to subject the payment of travel and subsistence expenses to tax and National Insurance. Instead, workers who genuinely carry out temporary contracts should be individually required to claim tax relief on travel and subsistence expenses at the end of each tax year.
- The remit of the Gangmasters Licensing Authority should be extended to include the construction sector.
- The bar set by HMRC for the criminal prosecution of labour providers who break the law should be lowered.

## Appendix



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Registered in England & Wales  
Company no. 3337373

Dear Jamie,

Following on from my conversation I have attached some information for your perusal and a link to our website.

**We are the only company able to offer our clients a 100% guarantee against tax and employment liabilities.**

Quite simply, Hudson Contract can help every construction business in the UK save money and eliminate the risk of tax and employment law challenges.

Hudson Contract saves you money and gives you greater flexibility by engaging your workforce on a self-employed basis... Equally important, our clients eliminate their tax and employment risks.

Hudson is the largest CIS Contract and Payroll Company in the market and experts in Tax and Employment Law. We are able to help your business in three areas:

- We take responsibility for HMRC Status Compliance under CIS
- We take care of Employment law issues
- We can save you money (20% of your labour costs) by reclassifying PAYE staff, paying them through CIS

### **HMRC Status Compliance**

We have recent evidence that HMRC is ignoring the problems faced by construction companies and pushing ahead with status inspections, and is handing out fines to companies that pay labour only subbies through CIS, that they believe should have been engaged on PAYE.

For those companies who engage some or all of their operatives under CIS, paying them through Hudson's absolutely takes away the risk of HMRC opening status investigations into your business.

# Appendix

## Employment Law

Some Unions promote holiday pay claims lodged by self employed operatives. We have successfully defended a number of these claims over the years. Self Employed operatives, paid under CIS deduction through Hudson are not entitled to holiday pay, redundancy or notice. We have the case law to prove it.

## Save Money

Many companies, including Kier, M V Kelly, Gallagher Group and Trad Scaffolding are now increasing their use of Hudson. We are helping companies to move their PAYE labour over to CIS, cutting their costs by 20%. Last year this saved our clients over £25M in Employers NIC, placing tax and employment law liabilities with us.

For further information regarding our service and business model please take a look at our website [www.hudsoncontract.co.uk](http://www.hudsoncontract.co.uk)

If you would like to discuss further please do not hesitate to give me a call.

Kind regards

**Dave Harris**

**Regional Account Manager**

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Jamie Elliott is a freelance investigative journalist, researcher and copywriter who specialises in employment issues and has written widely for the Guardian, Observer and other publications. His investigations have exposed the exploitation of migrant construction workers on an Olympics transport project, the mis-selling of worthless plumbing qualifications, national restaurant chains who use tips left by customers to pay the minimum wage, and the misuse of interns. He also teaches journalism and media law.



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