

**Low Pay Commission 2024
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 As a group of tax specialists with interest and insight into the pay and tax issues facing the low-paid, we welcome the opportunity to respond to this consultation from the Low Pay Commission (LPC).
- 1.2 In our response we focus on issues around compliance and enforcement of National Minimum Wage (NMW). In this context there are two recent developments in the labour market that affect lower paid agency workers and employees and we think raise important NMW questions. These are the growing number of (a) workers in the temporary labour market who on the face of it, are self-employed but actually have ‘worker status’ and may well be suffering an NMW breach, for example, where the elective deduction model (EDM) is used¹, and (b) salary advance schemes, where fees are payable by workers to third parties, which could reduce pay for NMW purposes.
- 1.3 We have interest and expertise in these areas because in both situations, action taken by HMRC for tax purposes has created the conditions that allowed these issues to thrive. We think it is vital that HMRC’s NMW unit factor these two specific issues into their approach.
- 1.4 While we frame our comments around the questions in the consultation on compliance and enforcement, we hope the information and insight we provide will be useful to the commissioners more widely.
- 1.4.1 For instance, we think the first issue could be growing partly as a consequence of pressure in job-driven markets created by recent substantial NMW rises – which, if correct, would be important when considering the desirability of future rate increases. Now that we are on the other side of the pandemic, we think new research should be urgently undertaken to look for any distortive behaviour

¹ In the elective deduction model workers are treated as self-employed for employment law purposes, but employed for tax law purposes.

like this in the labour market, particularly for vulnerable subgroups¹. It must look further than negative impacts within the employment setting and to alternative hiring arrangements, like 'self-employment'.

- 1.4.2 As the LPC's remit for 2024 includes closely monitoring the labour market and providing advice to the government on emerging risks², we also encourage the commissioners to gather evidence and consider recommending a change in the law, in respect of the second issue relating to salary advance schemes.
- 1.5 We know that the NMW has massively benefitted many low paid workers in many ways. However in our view, issues like EDM and salary advance schemes, although not directly NMW breaches, continue to contribute to the problem of low pay and the exploitation of workers. As the 'NMW - beyond 2024' report shows³, the NMW is a powerful tool and it could be used both directly - and indirectly - where necessary to address various labour market problems and challenges. We hope our insight prompts useful internal discussions about these wider issues, which may be relevant to future decisions about the path and role of NMW beyond 2024.
- 1.6 We are happy to discuss any aspect of our response in more detail if that would be useful.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those who are least able to pay for professional advice. We also produce free information, primarily via our website www.litrg.org.uk, to help make a difference to people's understanding of the tax system.
- 2.2 LITRG works extensively with key stakeholders such as HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the tax system. LITRG also considers the welfare benefits system, and other related systems, to the extent that they interact with tax.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and

¹ The Low Pay Commission Report 2023 notes 'negative employment findings' and puts them down to the pandemic but then goes on to say, 'we remain open to the possibility that an element of our findings reflects negative minimum wage effects. We will continue to gather more evidence to ascertain a clearer picture of the drivers of these results. We will update these analyses with new data when it becomes available. We also plan to expand our econometric analysis to include new data sources such as the PAYE administrative data.'

² <https://www.gov.uk/government/publications/national-minimum-wage-and-national-living-wage-low-pay-commission-remit-2024>

³ <https://www.gov.uk/government/publications/the-national-minimum-wage-beyond-2024>

practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

3.1 In recent responses¹ to the LPC we have raised considerations around large increases to the National Minimum Wage, namely:

- employers turning to options to displace increasing costs - not just the prima facie rate rise - but also employer's National Insurance contributions (NIC), holiday pay and pension contributions which are also based on the higher rates.
- interactions with tax, National Insurance and other systems, such as student loans, universal credit and tax credits meaning that increases may not translate into additional cash in the pockets of the lowest paid and
- the impact on the low paid self-employed who are obviously not covered by the NMW (although are impacted by increases via the Minimum Income Floor or MIF²) when they may not be able to simply increase their income in response to a minimum wage increase

3.2 While we consider these issues still apply and should be factored into any decisions on rate rises, this year we focus our attention on two discrete issues that are relevant to HMRC's compliance and enforcement work but are also important for the Low Pay Commission to understand and appreciate more widely.

3.3 In respect of the first bullet point however, now that we are on the other side of the pandemic (and other significant events such as leaving the EU) that may have clouded the picture, we would urge the LPC to urgently undertake new research to look for any negative impacts on workers of the recent increases, particularly for vulnerable subgroups. This should include looking whether there has been a shift to alternative work arrangements (such as 'self-employment'), as well as changes within the employment setting for example, redundancies/reduced hours/other trade-offs.

3.4 Some such self-employment will be genuine (although these individuals may still have 'worker status' – see para 4.1.13), however some of it will be false self-employment. As we said in our 2022 response: *From our considerable involvement with voluntary organisations and via feedback from members of the public to our website, we also strongly believe there is an increasing problem with the 'false self-employment' of low-paid workers. Historically, employer's NIC has tended to be the driving force behind false self-employment; however, we think that avoidance of work protections, including the minimum wage, may now be playing a part.*

¹ The response, along with all the detail, can be found here: <https://www.litrg.org.uk/submissions/low-pay-commission-consultation-2022>

² We explain about the MIF here: <https://www.litrg.org.uk/press-release/low-paid-self-employed-may-well-be-impacted-todays-minimum-wage-rate-increases-explains-litrg>

- 3.5 We know that the LPC are concerned about the social care sector and the affordability of future rate rises, without commensurate increases in funding¹. As such, it is important for the LPC to know that there seems to be an increasing number of self-employed workers in the care sector, many of whom appear to be falsely self-employed².

4 Questions

What issues are there with compliance with the minimum wage and what could be done to address these?

What comments do you have on HMRC's enforcement work?

4.1.1 Elective Deduction Model

- 4.1.2 The elective deduction model or EDM (also known as the hybrid model) is a particular model of engagement aimed at low paid agency workers in the temporary labour market. It exploits the fault line between employment law status and tax law status and creates a situation where a worker is treated as self-employed for employment law purposes and employed for tax law purposes.
- 4.1.3 Genuinely self-employed people do not have many employment law rights and protections. But in reality, it would be extremely unlikely for an agency worker to be genuinely self-employed for employment law purposes, as no matter what their contract says or which way you dress it up, they are working for someone else and not in business on their own account. This is, therefore, an example of bogus self-employment – it denies workers employment law rights and protections they are entitled to, to save the engager concerned money. But as the worker is employed for tax purposes, PAYE is operated and so on the face of it all appears to be in order.
- 4.1.4 EDM was first seen following HMRC's onshore intermediary legislative changes from April 2014, designed to clamp down on self-employed agency workers. But – as we pointed out in our consultation response³ - these changes worked for tax purposes only.
- 4.1.5 Historically, it has been a bit 'niche'. However the recent large NMW increases coupled with the fact no action has been taken to close this model down means it now appears to be mainstream. This is because it offers a solution to supply chains in job driven markets (basically where there are more candidates than jobs) where end clients have leverage and where there is simply not enough money flowing through the supply chain to allow everyone involved to cover costs and make their margin.

¹ See <https://www.gov.uk/government/publications/the-national-minimum-wage-beyond-2024>

² We summarise the entire landscape, in a submission we recently made to the Scottish government: <https://www.litrg.org.uk/submissions/employment-status-pas>

³ See <https://www.litrg.org.uk/submissions/onshore-employment-intermediaries-false-self-employment>. We also said it was a piecemeal approach that didn't offer a complete solution and would therefore be exploited.

Indeed, from a quick search on the internet, we can see that it is being openly marketed throughout the recruitment/umbrella industry.

4.1.6 We can provide the following example of the impact of the EDM on workers (based on a real life situation):

4.1.7 It is April 2024. A worker works a 37.5 hour week. His umbrella company receives £469.05 for his services for the week.¹ They use the money to carve out a gross pay for the worker of £429. On the face of it this looks like it meets the prevailing NMW rate of £11.44. They use the balance to fund employer NIC of £35.05 and to take a margin of £5.

4.1.8 However, this worker is in an EDM and the umbrella company is not setting any money aside out of the £469.05 received, to fund the worker's holiday entitlement or other costs of employment. A good compliant umbrella would do so. If it was setting money aside to cover these costs, they would only have a maximum of £382.61 left to carve out a gross pay for the worker². This equates to £10.20 per hour, which is significantly below the NMW.

4.1.9 His contract includes clauses and phrases such as

- Under this contract you will not be an employee or worker for general statutory employment rights purposes.
- All payments to you for services will constitute employment income but for tax and NIC purposes only.
- We will deduct PAYE and Class 1 NIC from payments made to you. We will also account for Secondary NIC on all payments made to you.
- Otherwise than as stated, you are a self-employed operative. You do not have any statutory right to paid holiday.

4.1.10 However, this worker's 'self-employed' label is meaningless as it doesn't reflect the reality of the working arrangements and the nature of the relationship between the parties involved³. The worker should at least have 'worker' rights. Depending which way you look at it, they are being incorrectly denied holiday pay (as a minimum) - or they are being underpaid the NMW.

¹To find a basic outline of how umbrella companies work, see <https://www.gov.uk/guidance/working-through-an-umbrella-company>

² You can check umbrella assignment rate to gross pay calculations via <https://payslipbuddy.co.uk/umbrella-company-calculator>. We include the output for an assignment rate of £469.05 as Appendix 1. Assumptions are that the worker has opted out of auto enrolment and that the Apprenticeship Levy is not payable.

³ See <https://www.gov.uk/government/publications/employment-status-and-employment-rights/employment-status-and-employment-rights-guidance-for-hr-professionals-legal-professionals-and-other-groups>

- 4.1.11 None of this will be clear from the workers' payslip – the only numbers that are likely to be visible are the gross pay amount of £429 and the relevant deductions from that to arrive at net pay. The fact that the worker has a payslip in the first place would disguise the fact that they are being treated as self-employed for employment law purposes. It would take a detailed NMW investigation by an officer with a good understanding of how employment status works, how umbrella companies work and an approach that looks behind the labels and payslip, to be able to understand that there could be an NMW underpayment here.
- 4.1.12 We know HMRC officers take the enforcement of NMW very seriously. However based on our experience and observations, we do not feel reassured that a worker presenting with this kind of scenario would be assisted with a complaint. We think it more likely that the worker will be informed there is no NMW issue or that there is an issue but it is one of holiday. As there is no state enforcer of holiday pay and the low paid rely on state enforcement to protect their positions, the mischief will likely go unpunished.
- 4.1.13 **Recommendation – Issues like EDM damage workers and the reputation of our labour market and enforcement regime. The LPC should try and ensure, as far as possible, that HMRC officers understand EDM and are not strict or sparing in their approach to it. Instead, they should be helpful, holistic and see the potential role that they could play in making engagement models such as EDM ineffective.**
- 4.1.14 Thinking beyond EDM, 'worker status' potentially applies to many other types of workers in the labour market who are being treated as self-employed by their engager, for example in the construction industry and gig economy¹. Even where the self-employment is genuine, our experience tells us that not many engagers will appreciate that some of their self-employed workers will have 'worker status'. Although we note that investigations based on worker status error are rising², they are still small. Also, from the recent LPC report on the gig economy³ we do not know whether HMRC officers really consider digging into status to be part of their NMW enforcement role or whether they would be more inclined to accept a self-employed status on face value.
- 4.1.15 **Recommendation: In our view, HMRC should do more to tackle the potentially serious breaches of minimum wage rules that can go hand-in-hand with worker status errors and in particular, false self-employment.**

¹ See our website guidance <https://www.litrg.org.uk/working/employment-status/employment-rights>

² 12 in the last educational bulletin linked to from this publication – <https://www.gov.uk/government/news/over-500-companies-named-for-not-paying-minimum-wage>

³ https://assets.publishing.service.gov.uk/media/663b5a144d8bb7378fb6c390/Self-employment_the_gig_economy_and_the_National_Minimum_Wage_1.pdf

4.1.16 As an aside, we would like to highlight that rolled up holiday pay became lawful for irregular and part year workers for holiday years starting from 1 April 2024¹. The legislation tells employers that they must itemise rolled up holiday pay on payslips² however we still think there is a risk that unscrupulous employers will try and use the payment of rolled up holiday pay to count towards the NMW. HMRC compliance and enforcement officers need to be alive to this.

4.2 Salary advance schemes

- 4.2.1 Salary advance schemes provide employees with the option to receive a proportion of their salary before their regular payday, to help manage their finances. The schemes often involve employers using a third party provider, who make advances to employees for a fee³. There are both benefits and drawbacks to the schemes, not least that they are not regulated – although some of the providers in the market have now signed up to a code of practice⁴. Their emergence would seem to be linked to the transition from weekly to monthly payrolls, driven by the more onerous administrative burden for employers of HMRC's real time information (RTI) regime when running a weekly payroll⁵.
- 4.2.2 Up until 6 April 2024, the strict position was that salary advances should be treated as payments on account of earnings and, as such, should have been reported via the PAYE system on or before the payment date. However, the salary advance schemes were typically sold by the third party providers as requiring no additional RTI payroll returns.
- 4.2.3 Rather than trying to counter the misinformation and distortive practices happening in this space, HMRC instead updated legislation around reporting salary advances to ease the administrative considerations⁶. In our response to the consultation, we said there was a risk that schemes will now grow in popularity as a result of the changes and more employers will likely consider them. This is because the changes would give certainty that no additional RTI payroll returns are required.
- 4.2.4 We remain concerned about the schemes in general and the decision by HMRC to amend the legislation to legitimise the practice used by the schemes. In addition, we also have technical questions about the NMW position.

¹ See GOV.UK guidance: <https://www.gov.uk/government/publications/simplifying-holiday-entitlement-and-holiday-pay-calculations/holiday-pay-and-entitlement-reforms-from-1-january-2024>

² <https://www.legislation.gov.uk/ukxi/1998/1833/regulation/16A>

³ We look in detail at how salary advance schemes work in our blog: <https://www.tax.org.uk/salary-advance-serves-up-tricky-conundrum-for-hmrc>

⁴ <https://www.cipp.org.uk/best-practice/ewa-code.html>

⁵ The full background is set out here: <https://www.litrg.org.uk/submissions/salary-advance>

⁶ <https://www.gov.uk/government/consultations/draft-regulations-proposed-amendments-in-respect-of-salary-advances>

- 4.2.5 Our understanding¹ is that when the salary advance is made the amount is not taken into account as part of NMW pay. The recovery of a salary advance is not a reduction in pay for NMW purposes. To achieve this, it would be important for employers to make sure the documentation/payslip entries were absolutely correct. However, we are less clear on whether the fees that are paid to the schemes should count as a reduction in NMW pay - which could then bring employees' pay beneath the prevailing NMW hourly rate.
- 4.2.6 The issue here is that rather than being used in an emergency, we think the schemes are being used by employees to simulate being paid weekly as far as is possible under the scheme rules. As such, the amounts paid in fees, by probably increasing numbers of employees as schemes gain momentum in the labour market, can quickly mount up.
- 4.2.7 HMRC have shared very little insight with us as to their view of the status of this fee. We are not NMW technical experts, but based on our own research we think the fee might be for the use and benefit of the employer² and therefore reduce pay for NMW purposes in the following situations:
- Where the schemes are providing their own employees with drawdown facility
 - Where the scheme and the employer are connected – e.g. share a director
 - Potentially where the scheme is paying a commission or fee to the employer for introductions
 - Where the employer pays the fee in the first instance and then recoups it later from the employee
 - Where the employee initially pays the fee, but the employer is underwriting it (for example, in cases where the employee actually doesn't have enough pay to cover all the deductions). What we mean here is that the employer is contractually 'responsible' for any shortfalls/ for paying fee of the employee, even if most of the time the employee discharges the obligation by paying it.
- 4.2.8 This is obviously extremely complex. Yet HMRC's update to employers in the CWG2³ - remembering that employers are the ones that have the employment relationship with the employee and so remain legally responsible even though payments are administered elsewhere – simply says: 'Employers must account for their National Minimum Wage obligations when considering advances involving a fee.'
- 4.2.9 There is no detail anywhere that we can find to support employers and to help them understand what, exactly, the NMW position is around the fee.
- 4.2.10 **Recommendation: If one of the aims of HMRC NMW unit is to help employers be compliant, the current guidance is not adequate. HMRC should produce more comprehensive guidance on salary advance schemes, including on the status of the third party fees, as a matter of urgency. This should then be promoted to employers so that they understand their obligations and can make an informed decision as to any risk and therefore whether to go ahead with implementing such a**

¹ <https://www.gov.uk/hmrc-internal-manuals/national-minimum-wage-manual/nmwm09210>

² <https://www.legislation.gov.uk/uksi/2015/621/regulation/12/made>

³ See para 1.8.1. <https://www.gov.uk/government/publications/cwg2-further-guide-to-pay-and-national-insurance-contributions/2024-to-2025-employer-further-guide-to-pay-and-national-insurance-contributions>

scheme (or whether, for example, to switch to weekly pay periods or whether to offer advances to employees directly, without needing to use fee-charging schemes).

- 4.2.11 Outside the scenarios above, we understand that even though the worker is using the third party service to better align their work and earnings and this undoubtedly provides an advantage to the employer who might otherwise face quite a lot of payroll administration in running more frequent payrolls, this reason alone is not enough to make the fee fall under use and benefit rules. We would appreciate confirmation of this. If, in general situations, the fee does *not* currently fall under the use and benefit rules, then we think there is a case for those rules to be changed to protect low paid employees.
- 4.2.12 **Recommendation: We urge the commissioners to undertake a review of the salary advance market so as to better understand the nature and scale of scheme use, and to recommend a tweak to the law if deemed necessary to protect low paid employees.**

LITRG

4 June 24

Appendix 1**Full Details**

Umbrella Rate	£469.05
Employment Costs	£86.44
NIER - Employer NI	£28.65
Holiday Pay	£46.18
Accrued Employment Costs over Holiday Pay	£6.60
Umbrella Margin	£5.00
Pay Details	
Tax Code	1257L
NI Category Letter	A
Gross Income	£382.61
Basic Pay	£382.61