Institute of Interim Management

Umbrella Companies Scheduled to get Severe 'Dousing' in 2026?

Executive Summary

The draft legislation, published in July 2025 and set to take effect from April 6, 2026, marks a fundamental re-engineering of the UK's temporary labour market. At its core, the new Chapter 11 in Part 2 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) introduces a new and impactful concept: Joint and Several Liability (JSL) for unpaid PAYE tax and National Insurance Contributions (NICs) in umbrella company supply chains. This measure is HMRC's direct response to a decade of widespread non-compliance and tax loss estimated at nearly £1 billion annually, primarily orchestrated by unscrupulous umbrella companies.

The pivotal change is that recruitment agencies and, in some circumstances, end clients will now be held legally and financially accountable for any tax that a non-compliant umbrella company fails to remit to HM Revenue and Customs (HMRC). This liability is strict, without statutory defences, indicating that even a prudent party may be fully accountable for the total tax obligation, including penalties and interest. The government's message is unequivocal: control of the labour supply chain now comes with an inescapable liability. This report provides a detailed breakdown of the legislation, its profound implications for all stakeholders, and a prescriptive roadmap for effective risk mitigation and compliance in this new operational landscape.

1. Introduction: The UK Umbrella Company Market at a Crossroads

The UK's temporary labour market has undergone significant transformation in recent years, particularly since the 2021 off-payroll working reforms (IR35). These changes prompted a substantial number of organisations in the public and private sectors to engage workers through umbrella companies, leading to a notable growth in the use of umbrella companies.[1] However, this expansion has been accompanied by a persistent and widespread pattern of non-compliance. Unscrupulous operators have utilized fraudulent practices, including disguised remuneration schemes, deliberate under-reporting of income, and the formation of "mini-umbrella company" schemes, to artificially inflate take-home pay and reduce tax liabilities.[3]

HMRC data for the 2022-2023 tax year indicates a concerning £500 million loss attributed to disguised remuneration schemes, almost all of which were apparently facilitated by umbrella companies.[3] The total tax gap from this non-compliance is estimated to be nearly £1 billion a year.[1] This behaviour has not only eroded the Exchequer but has also created a distorted and unfair market, allowing fraudulent operators to undercut compliant companies. The ultimate cost has been borne by the workers themselves, who are often left with large, unexpected tax bills after their umbrella company absconds with the funds.[3]

For over a decade, the government has attempted to address this issue through guidance, collaboration with industry bodies, and nudges towards self-regulation. However, as the evidence suggests, these efforts were insufficient, and non-compliance persisted.[1] The new Joint and Several Liability (JSL) legislation is therefore considered a "last resort" to achieve a trifecta of policy objectives: to close the tax gap by protecting taxpayers and the Exchequer, to shield temporary workers from unexpected tax liabilities, and, to ensure the temporary labour market operates on a level playing field by preventing fraudulent businesses from gaining an unfair competitive advantage.[3]

It is important to understand that this JSL measure is a tax-focused reform, set to be introduced in the Finance Bill 2025-26 and effective from April 2026.[2] This initiative is distinct from the forthcoming regulation of umbrella companies under the Employment Rights Bill. That separate legislation, scheduled to take effect in 2027, is expected to legally define umbrella companies and bring them under the remit of the Employment Agency Standards Inspectorate and the proposed Fair Work Agency.[2] The government's decision to implement the severe JSL tax measure first, followed by the broader regulatory framework, represents a strategic, phased approach to market reform. The immediate severity of the JSL measure is designed to act as a powerful market enforcement mechanism, forcing out unscrupulous operators and consolidating the market. This aims to establish a more orderly and stable environment for future comprehensive employment regulation.

2. A Technical Deep Dive into the New Legislation

2.1. The New Chapter 11, ITEPA 2003

The draft legislation amends Part 2 of the Income Tax (Earnings and Pensions) Act 2003 by inserting a new Chapter 11, encompassing sections 61Y to 61Z1.[2] The new chapter establishes the legal framework for joint and several liability (JSL) for any amount payable under PAYE provisions, including Income Tax, Class 1 NICs, and the Apprenticeship Levy.[10]

The legislation provides HMRC with new powers to enforce this liability. New item 7ZA is being introduced into section 684(2) of ITEPA, giving the Commissioners for HMRC the ability to make regulations connected with the recovery of amounts to which a relevant party is jointly and severally liable under Chapter 11.[10] Additionally, the regulation-making power in section 716B ITEPA, which relates to employment intermediaries' requirements to keep, preserve, and provide information, will be extended to purposes related to the new Chapter 11.[10] These provisions underscore the government's commitment to providing HMRC with the necessary tools to pursue and recover tax debts from parties further up the supply chain.

Key Provisions of New Chapter 11, ITEPA 2003	
Section	**Legal Significance**
61Y	Sets out the basic conditions for the creation of a joint and several liability where a worker is supplied via an umbrella company.[9]
61Z	Defines the parties that will be considered "relevant parties" and therefore subject to joint and several liability.[9]

61Z1	Establishes a separate set of conditions that trigger joint and several liability in respect of "purported" umbrella companies.[3]
684(2) Item 7ZA	Grants HMRC Commissioners the power to make regulations for the recovery of amounts from jointly and severally liable parties under Chapter 11.[10]
716B	Extends HMRC's regulation-making power to include information-gathering from employment intermediaries for purposes related to Chapter 11.[10]

2.2. The Principle of Joint and Several Liability (JSL)

Joint and several liability is a legal doctrine where multiple parties share responsibility for a debt, and each party is individually liable for the entire amount.[11] The principle originated from the concept that "the act of one is the act of all".[11] In this legislative context, JSL is a powerful enforcement tool that allows HMRC to pursue full payment of a tax debt from any or all of the responsible parties, without needing to first exhaust options with the party that incurred the initial liability.[13] The principle's strength lies in its ability to allow a plaintiff to collect compensation more efficiently, often by pursuing the party with the "deepest pockets".[12]

A critical and defining aspect of the new legislation is the absence of any statutory defence for a relevant party.[3] This is a significant departure from other tax compliance frameworks, such as certain provisions of the off-payroll working rules. It means that an agency or client could have conducted extensive due diligence, acted in good faith, and still be held liable for unpaid taxes. The liability is absolute, regardless of the level of care taken.[2] The draft legislation explicitly grants HMRC the power to go straight to the agency for unpaid tax, without first attempting to recover it from the umbrella company, which could result in substantial financial exposure for the agency.[13]

2.3. Defining "Relevant Parties"

The draft legislation applies JSL to the umbrella company and "other 'relevant parties'" in the supply chain.[2] The primary relevant party targeted by the new rules is the

recruitment agency that holds the direct contract with the end client to supply the worker.[3] This is because agencies are perceived as having the most control over who enters their labour supply chains.[6]

In instances where a supply chain does not include an agency—that is, where the end client engages directly with an umbrella company—the liability for unpaid tax shifts to the **end client**.[3] The rules are also designed to capture Managed Service Providers (MSPs) and other top-tier parties in complex supply chains, placing them in a position of potential liability.[2] The legislation is structured to ensure that, regardless of the specific contractual arrangements, a party with financial means and control will be held accountable.

2.4. Tackling "Purported" Umbrella Companies

The legislation includes specific provisions to address non-compliance by "purported umbrella companies".[3] These are businesses that operate under the guise of a compliant umbrella company but do not adhere to legal or financial standards, often through activities such as worker misclassification or the diversion of payments to avoid payroll taxes.[3]

A new provision within section 61Z1 applies JSL to these arrangements, particularly when a worker holds a material interest in the purported umbrella company and there is a "reasonable supposition" that one or more participants in the arrangements would assume the purported umbrella company would pay the worker a substantial proportion of the amount it received as earnings but did not.[3] The measure is designed to close any loopholes that allow fraudulent or non-compliant schemes, including mini-umbrellas and offshore vehicles, to circumvent the legislative provisions and continue their avoidance activities.[2]

3. Operational and Strategic Implications for the Supply Chain

3.1. Impact on Recruitment Agencies and Managed Service Providers (MSPs)

Recruitment agencies and MSPs are the stakeholders most profoundly impacted by the new legislation.[2] They now face substantial financial exposure, as they can be held liable for all unpaid PAYE, NICs, and AL, plus associated penalties and interest, without HMRC first attempting to recover the debt from the umbrella company.[3] This liability is for all workers paid through a non-compliant umbrella, making the risk systemic rather than isolated to a single engagement.[1]

This systemic nature of the risk presents a significantly greater threat than anything firms faced under the off-payroll working rules. While IR35 risk was typically contained to a single contractor, the JSL rules mean that a single non-compliant umbrella company could lead to a catastrophic, company-wide tax debt that could bankrupt an agency.[1] This new magnitude of risk forces agencies to take far greater responsibility for their supply chains and will necessitate a complete overhaul of their operational and due diligence processes.[13] Furthermore, being part of a non-compliant arrangement carries a heightened reputational risk, which could lead to a loss of clients who demand supply chain transparency and compliance.[2]

3.2. Impact on End Clients

While recruitment agencies are the primary targets of the legislation, end clients are not immune from its effects. They will be held liable if they engage directly with an umbrella company with no agency in the supply chain.[3] Even when an agency is involved, the risk is not completely eliminated. End clients face potential liability if the agency and umbrella are deemed "connected parties" or if a complex supply chain makes it difficult to trace liability.[1] End clients operating under the Senior Accounting Officer (SAO) regime will need to update their documented processes and controls to ensure they are sufficient to address these new risks.[2]

The new JSL regime will also have a cascading effect on the entire supply chain. As agencies face this new, significant liability, they will pass due diligence and contractual requirements up the chain to end clients. This dynamic will force end clients to conduct more rigorous oversight of their resourcing partners and reassess their engagement models.[2] Some end clients with significant bargaining power may find it more viable to in-source payroll to regain direct control over their PAYE risk, while others may shift their temporary worker engagements to internal PAYE or fixed-term contracts to avoid the new liability altogether.[1]

3.3. Impact on the Umbrella Company Market

The legislation is expected to catalyse a significant consolidation within the umbrella company market.[2] Recruitment agencies, in a bid to mitigate their new JSL exposure, will be much more cautious about which umbrella companies they engage with. This will lead to a dramatic shrinking of agency Preferred Supplier Lists (PSLs) to include only the most reputable, transparent, and compliant providers.[2]

For umbrella companies, compliance will move from being a desirable attribute to a commercial necessity. Those with robust internal controls and a demonstrable track record of correctly and timely remitting income tax and NICs to HMRC will be able to differentiate themselves from their competitors and secure a greater proportion of the market.[2] Conversely, "bad actors" and fraudulent operators will find it increasingly difficult to gain access to the market and will likely fail as agencies and clients refuse to work with them.[2]

3.4. Impact on Temporary Workers

The legislation is designed to protect temporary workers from the significant tax bills they have previously faced due to non-compliant umbrella companies.[6] However, the changes will not be without consequence. Workers who are currently being paid through non-compliant, disguised remuneration schemes that offer artificially high take-home pay may experience a reduction in their net income as they are transitioned to fully compliant models.[15]

Furthermore, the new, rigorous vetting by agencies may result in workers having to switch providers, leading to administrative burdens like starter/leaver issues and breaks in employment continuity.[15] The broader market impact could also result in a "heightened reluctance by agencies and end clients to work with umbrella companies" altogether, potentially leading to fewer umbrella options or a shift toward agency-based payroll, which could affect a worker's desired flexibility.[1]

4. Mitigating Risk: Enhanced Due Diligence and Compliance

4.1. The End of Traditional Due Diligence

The new legislation fundamentally changes the requirements for due diligence. Traditional methods—such as relying on third-party accreditations, light-touch policies, or occasional spot checks—are no longer sufficient to mitigate the risk under the new strict liability framework.[14] These traditional frameworks were never designed to answer the key questions that now matter most to a relevant party: Has the tax been correctly calculated on each payslip, has the correct amount been disclosed to HMRC via Real Time Information (RTI) submissions, and has that tax actually been paid to HMRC?[14]

The new regime demands a proactive and continuous approach to compliance verification, moving away from passive trust to active proof.

Due Diligence Framework: Before and After Legislation	

Before JSL Legislation (Pre-April 2026)	After JSL Legislation (Post-April 2026)
Reliance on third-party accreditations (e.g., FCSA) as primary assurance.[14]	Accreditations are a starting point, but must be supplemented by internal, continuous controls.[2]
Periodic, infrequent reviews or sampling of payslips and documents.[2]	Ongoing, real-time validation and cross-referencing of payslips and tax filings.[2]
Due diligence is often seen as an initial, one-time exercise at the point of onboarding.[14]	Due diligence is a continuous, operational process with the goal of verifying tax remittances in real time.[2]
Contractual terms may lack explicit data provision or indemnity clauses for tax liabilities.[2]	Contracts must be updated to include robust indemnities, SLAs, and data-sharing provisions to validate compliance.[2]

4.2. The Imperative for Real-Time Verification

Due to the nature of PAYE regulations, there is a time lag between when a worker is paid and when the PAYE remittance is due to HMRC, typically by the 22nd of the following month.[1] This window creates a period of liability accumulation for agencies and clients, who remain exposed until they can prove that the tax has been paid. To mitigate this inherent risk, enhanced diligence must extend beyond payslip sampling to include continuous, real-time verification of payslips and filings and cross-referencing with actual remittances to HMRC.[2] The core of the new due diligence model lies in implementing systems that can provide continuous, verifiable proof of tax remittances.[14]

4.3. Proactive Supply Chain Governance

In response to the new liability, agencies and clients must proactively review and update their contractual terms with umbrella companies.[2] New contracts should include explicit and robust indemnities to cover potential tax liabilities, clear service level agreements, and provisions for data-sharing to validate compliance and the use of insurance protections.[2] For end clients, it is advised to assess their supply chains to ensure that PAYE liabilities cannot be passed up the chain, whether contractually or as a result of the new legislation. This includes seeking assurance that the agencies they work with are UK resident and are not using any "connected umbrella companies," as these scenarios could lead to a joint liability for the end client.[1]

5. Recommendations for Actionable Change

5.1. Strategic Responses for Agencies and Clients

Organizations must move from a reactive position to a proactive strategic and operational response. There are three primary strategic options for agencies and clients:

- **In-Sourcing Payroll:** For some, particularly large end clients with significant bargaining power, taking payroll in-house may be the most viable option to eliminate JSL risk and gain full control.[1] This approach, however, may not be suitable for all, as it requires significant administrative and operational investment and could have a negative competitive impact for recruitment agencies.[2]

- **Direct-to-HMRC Payment Models:** A less risky alternative is for agencies or clients to pay the net amount directly to the umbrella company while paying the PAYE directly to HMRC under the umbrella's tax reference.[1] This model puts control "firmly back in the hands of agencies and clients," providing certainty that the tax has been remitted.[1]
- **Rigorous PSL Management:** For those who continue to rely on umbrella companies, a dramatic shrinking of the Preferred Supplier List and the implementation of a continuous, real-time auditing and verification system will be a mandatory step to manage risk.[13]

New Risks and Recommended Actions by Stakeholder	
Stakeholder	**New Risks**
Recruitment Agencies	Substantial JSL for unpaid PAYE, NICs, and AL. Reputational damage and loss of clients.[2] Operational burden of enhanced due diligence.[2]
End Clients	Indirect JSL risk through complex supply chains or "connected parties".[1] Direct liability if engaging umbrellas without an agency.[10] Reputational risk.[2]
Umbrella Companies	Loss of market share due to heightened agency and client due diligence.[2] Increased operational costs to provide real-time proof of compliance.[2]
Temporary Workers	Potential reduction in take-home pay if currently using non-compliant schemes.[15] Administrative burdens from switching providers.[15] Potential for fewer umbrella options or a shift to agency-based payroll.[1]

5.2. Practical Steps for Business Preparation

The implementation date of April 2026 provides less than a year for the industry to prepare. A structured and immediate response is critical.

- **Immediate Action (Now to Q4 2025):** Establish a cross-functional task force comprising legal, finance, and operational leaders. Conduct a comprehensive review of all current labour supply chains and engagement models to identify areas of risk.[2] Begin a full, independent audit of all umbrella companies currently on the Preferred Supplier List. Concurrently, review and renegotiate contractual terms with existing umbrella partners to include new safeguards, indemnities, and data-sharing agreements.[2]
- **Q1 2026:** Based on the risk assessment and legal reviews, a chosen strategy (in-sourcing, direct payment, or enhanced PSL) should be finalized. Begin the technical and operational implementation of the new processes, including any required technology solutions for real-time verification.
- **April 2026 and Beyond:** The new due diligence framework must be fully operational and continuously monitored. The organization should maintain an ongoing dialogue with its supply chain partners and remain abreast of new guidance from HMRC, which is expected to be published in the autumn of 2025.[13]

6. Conclusion: A New Era of Corporate Responsibility

The introduction of Joint and Several Liability marks a pivotal moment for the UK's temporary labour market. It is not merely a technical tax amendment but a profound and intentional policy shift from a reactive, employer-centric liability model to a proactive, supply-chain-wide responsibility framework. The government's message is unequivocal: control of the supply chain now comes with an inescapable liability. This will lead to a cleaner, more consolidated market, but it will also place a significant burden on recruitment agencies and end clients, forcing a fundamental reassessment of how they engage with their flexible workforce. The era of passive reliance on third-party assurances is over. The new imperative for every organization operating in this market is transparency, continuous verification, and an unwavering commitment to ensuring that tax is not just deducted but also remitted. The financial and reputational stakes have never been higher, and proactive preparation is the only viable path to mitigate the new risks.

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