

Guidance Note for Payroll Companies

Ethics, compliance with regulations and with the expectations of society are core principles of LHV's business. High ethical standards also cascade to LHV customers and we expect our customers to value and show similarly high ethical principles, compliance standards, and risk management. This Guidance Note is being shared with all of our clients to reinforce our expectations with respect to managing the financial crime risk associated with providing payment services to payroll companies.

Background

Payroll companies collect funds from employers to pay the salaries of their employees and contractors, and make disbursements for tax, national insurance and other deductions as well as making payments of the nett proceeds to the employee or contractor. This can be either through providing a payroll service to another business in relation to that company's employees (in which case the employer is the payroll company's customer), or to provide a service to contractors by invoicing the employing business for the services provided by the contractors (in which case the contractor is the payroll company's employer, and the payroll company must have a good understanding of the rationale for use of this type of model including whether it complies with relevant legislation, including IR35).

Regulatory environment

Certain payroll companies, including those that provide accountancy services or tax advice, fall within the regulatory perimeter and are obliged to register with HMRC under the Money Laundering Regulations. Other payroll companies, including those that pay invoiced service fees to self-employed people, umbrella companies or other corporate service providers; companies that operate as an umbrella company to carry out payroll functions for individuals working on assignments for an end client; and companies such as recruitment agencies for whom payroll is an ancillary part of their business, do not need to register and remain unsupervised¹.

Vulnerabilities

Whether supervised or not, payroll companies are exposed to unique financial crime threat vectors. LHV expects its financial intermediary clients to undertake appropriate due diligence on their clients that operate as payroll companies to understand and mitigate the unique risks to which they are exposed. Specific vulnerabilities that payroll companies may be exposed to include:

- Tax evasion or avoidance using sham umbrella arrangements²;
- The misuse of mini umbrella arrangements to avail of tax advantages in a manner not intended by legislation³;
- Creation of fictional employment arrangements using shell companies where the source of funds is questionable and potentially funded by the proceeds of crime⁴;
- Criminal actors creating ghost employees or contractors using real or fictitious personal details⁵;
- Money launderers using payroll companies to add an additional layer of perceived legitimacy to the criminal's financial arrangements;
- Criminals purporting themselves, or entities or individuals under their control or influence, to be both employer and employee or contractor as part of the layering process⁶;

1. <https://www.gov.uk/guidance/money-laundering-regulations-accountancy-service-provider-registration>

2. <https://www.gov.uk/guidance/working-through-an-umbrella-company>

3. <https://www.bbc.co.uk/news/uk-57021128>

4. <https://www.moneylaundering.com/wp-content/uploads/2021/09/IsleofMan.Guidance.AMLCTF.9321.pdf>

5. <https://www.moneylaundering.com/wp-content/uploads/2021/09/IsleofMan.Guidance.AMLCTF.9321.pdf>

6. <https://www.moneylaundering.com/wp-content/uploads/2021/09/IsleofMan.Guidance.AMLCTF.9321.pdf>

- Perpetration of VAT evasion or MTIC carousel fraud through provision of service fees;
- The risk that the employees or contractors may be the victims of modern slavery or human trafficking⁷, including the perpetration of organised immigration crime, or employers may not be fully discharging their obligations to pay National Minimum Wage⁸; and
- The prospect of unwitting, otherwise legitimate employers using a payroll company that falsifies taxation records and payslips to evade, underpay or otherwise fail to account for tax, national insurance, and VAT⁹.

Expectations

LHV expects its clients that provide services to payroll companies to pay specific attention to the measures employed by the payroll company to establish the authenticity of the payroll arrangements it provides.

This includes:

- Understanding the due diligence measures that the payroll company employs to assess the legitimacy of umbrella and mini-umbrella arrangements;
- The due diligence undertaken by the payroll company on the authenticity of the employing entities that it serves;
- Understanding the commercial nature of the relationship between the payroll company and the employer, including where necessary assessing the authenticity and legitimacy of contractual documentation;
- Assessing the measures that the payroll company takes to verify the legitimacy of the employment arrangements, including the identity of the employees or contractors; and
- Reviewing the measures employed by the payroll company to prevent and detect the misuse of its services to facilitate modern slavery or human trafficking, or the refusal or wilful neglect to pay National Minimum Wage.

LHV expects that its clients will have in place reasonable measures at customer onboarding and throughout the course of the customer relationship to identify, manage, monitor and mitigate these risks. As well as undertaking due diligence at onboarding, this should also include measures to monitor customer instructions, transactions coming into and going out of customer accounts, and ongoing assessment of the customer relationship. Where a payroll company is known to use outsourcing arrangements, clients should understand the nature and purpose of the outsourcing, and assess and mitigate any money laundering or terrorist financing risk inherent in the arrangement.

As with any customer relationship, clients should be alert to the presence of 'red flags' that may be indicative of a higher risk of financial crime. As well as the usual financial crime 'red flags' that apply to any customer relationship, clients that service payroll companies should be vigilant for:

- Unnecessary steps or entities introduced into the payroll flow, including payments between payroll companies;
- Payments of an amount, whether individually or in aggregate, that are materially divergent from the market rate for a particular job role;
- Transactional patterns that are inconsistent with the expected size or scale of the ultimate employer;
- Large discrepancies between the wages paid to different workers doing similar jobs;
- Excessive payments from a single employer made to family members of the employer or its controller;
- Multiple payments to the same account, for example, multiple wages received from different companies in the same period;
- Discrepancies between the amounts of inbound payments and the disbursements to employees and HMRC;
- Payment of tax or national insurance contributions in an amount that is not consistent with the value of the purported salaries being paid;

7. <https://www.nationalcrimeagency.gov.uk/who-we-are/publications/434-indicators-of-msht-in-the-accountancy-sector/file>

8. <https://www.gov.uk/hmrc-internal-manuals/national-minimum-wage-manual/nmwm12250>

9. <https://www.att.org.uk/employers/welcome-employer-focus/check-signs-payroll-company-fraud>

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- Use of a “benefit pool” where payments above minimum wage are structured as unsecured loans or paid into unregistered defined benefit pension schemes to reduce tax liabilities; and
- Implausibly low staffing costs as compared to the size, scale and complexity of the employers.

This document has been prepared for educational purposes to share information about LHV’s expectations of its clients with respect to managing the financial crime risk associated with providing payment services to payroll companies, and is not a definitive statement of the law. Client’s must seek their own legal advice on the points raised and must not rely on this Guidance Note. This Guidance Note shall form part of the Payment Services Agreement between LHV and its clients, and in the event of any conflict between this Guidance Note and the Payment Services Agreement, the Payment Services Agreement shall prevail.

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