

# **Low Pay Commission:**

Non-compliance and enforcement  
of the National Minimum Wage  
September 2017

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# Executive Summary

The nature and extent of non-compliance with the minimum wage is a very important consideration for understanding the impact of a higher pay floor on living standards: workers only benefit if they receive the correct rate.

Last year's introduction of the National Living Wage (NLW), a higher rate for workers aged 25 and over, was a substantial intervention in the labour market that raised the number of workers covered by the rate sharply from 1 million to 1.6 million, and had clear implications for compliance. We were also interested in looking further because of the changing policy regime. Funding for enforcement has increased and is set to rise further and greater use has been made of the policy tools available, such as naming employers found to underpay. For these reasons, the Commission decided on a stand-alone report, where the issues could be examined in greater detail.

Last year we reported preliminary evidence that the new rate had been accompanied by a large increase in the number of workers aged 25 and over paid below the level of the minimum wage. But technical issues around the timing of the evidence meant it was hard to know if this was a real change or not. This report's updated analysis shows that while our estimate of the number of underpaid workers in this age group has indeed risen since the NLW's introduction (from 203,000 to 278,000) it has done so by less than the increase in workers covered by the rate. This means that the share of workers paid at or below the NLW who are underpaid has fallen slightly from 14 per cent to 13 per cent.

There is also a strong frictional or seasonal pattern to underpayment. It is highest immediately after an uprating, but then falls by around half over the months that follow. At its peak in the year we estimate that between 305,000 and 579,000 could be underpaid.

The increase in the scale of non-compliance in pure volume terms supports the decision to increase the budget of HMRC – the body responsible for enforcing compliance on behalf of BEIS. As the NLW rises we estimate that HMRC will have the job of policing the pay of 3.3 million workers by 2020, up from 2.3 million now. As the number of workers covered by one of the rates rises it is likely that the number of underpaid workers will also rise, supporting the decision to increase the budget.

Real improvements in enforcement activity have already been delivered with a shift to more proactive investigations and more use of 'self-correction' resulting in higher arrears and more workers identified by HMRC. In particular, the proactive approach may be important for not only counterbalancing the low volume of complaints and enquiries that workers make about underpayment but also addressing imbalances across different groups of workers.

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This is exemplified by the gender differentials in non-compliance. Two thirds of the underpaid workers identified by HMRC as part of their investigations are women, which matches our estimates from earnings data. However, qualitative research suggests that women may be less likely than men to complain if they are underpaid, either to their employer or the ACAS helpline; the formal route for such concerns. The Government's evidence to us corroborates this: in 2016/17 just over half of enquiries about underpayment came from women; fewer than the two thirds that we'd expect. This suggests that the proactive approach may be mitigating the reluctance or inability to complain that some groups of workers may have.

Lack of awareness is one of the reasons for not complaining across all underpaid workers. Over half of low-paid workers think that the law allows them to agree to be paid less than the minimum wage. A similar proportion were unaware that tips cannot 'top up' pay to the minimum. Further, two fifths were unaware that they can legally claim back lost earnings.

For this reason the Government's recent communications campaign around the April 2017 upratings was welcome. Our analysis suggests that this campaign may have led to lower underpayment following the introduction of the NLW than otherwise would have been the case. If this is indeed the case then this is another good example of the real successes in tackling non-compliance that have taken place in recent years. But there are areas where Government could go further. The final chapter sets out our recommendations in full but we summarise them briefly below.

Government should fully evaluate its communications efforts and look to repeat them each year alongside the NMW (National Minimum Wage) and NLW upratings if they are shown to raise awareness and reduce underpayment. This should be combined with a broader approach aimed at raising the number of formal complaints made by workers to the ACAS helpline, which remain low relative to our estimates of the scale of underpayment. This includes better publicity around the third party complaints process, developing case studies and/or guidance based around successful complainants and publicising the improvements in the time taken to resolve a case.

For employers we recommend improved guidance around the technical errors that other employers have made, so they can learn from each other's mistakes. But we also need action on recalcitrant employers, so efforts to both increase the number of prosecutions and publicise those that do occur would be welcome. The naming rounds, including the most recent in August of this year, have been successful in generating press attention and raising awareness. Making naming of employers a more regular and predictable occurrence may help build on this momentum and increase press anticipation of the announcement.

Qualitative research continues to show that a small core of recalcitrant employers remain unconcerned by the consequences of their non-compliance. For example, some believe that their staff won't complain, others are unaware of the increased resources for HMRC or the increased use of naming. Action to publicise the increase in enforcement activity e.g. the number of complaints or the number of cases investigated, perhaps by sector and locality may help get the message through. Adding a simple 'tick box' declaration to payroll software whereby the employer is asked to confirm that all of their staff are paid at the correct level could also be a helpful 'nudge' to encourage compliance.

Finally, there are a range of actions for HMRC. We recommend that HMRC establishes information systems that allow Government to learn as much as possible about the nature and extent of non-

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compliance from the cases it investigates. These information systems should provide enough information to monitor how well policy is responding to the challenge overall as well as on specific groups and issues. The new apprenticeship levy system, also managed by HMRC, will provide intelligence on which employers are paying the levy and, potentially, what types of apprenticeship they are studying. If this is the case it may allow HMRC to identify employers at risk of underpaying their apprentices. HMRC should use this intelligence as part of their risk based approach to proactive investigations to help tackle the high levels of non-compliance amongst apprentices. Finally, there are opportunities for HMRC to gather intelligence from other parts of Government. This includes testing processes for automatic referral from other inspection bodies and working with Jobcentre Plus' Universal Jobmatch Team to identify online job adverts that appear to be non-compliant.

# Introduction

**1.1** Traditionally each Low Pay Commission annual report contains a chapter looking at enforcement and non-compliance with the National Minimum Wage, which is where workers are paid below the legal minimum. However, instead, we are publishing this separate report, which considers the nature and extent of non-compliance, reflects on the current policy response and makes policy recommendations where necessary. It was prompted by the introduction of the National Living Wage in April 2016, a higher rate for workers aged 25 and over, which raised the numbers covered by the minimum wage sharply, and the reach of the policy into low-paying industries.

**1.2** Minimising non-compliance is hugely important, both for ensuring the rights and incomes of low-paid workers and for making sure employers are not undercut by unscrupulous competitors. It's also important for the Low Pay Commission, as there would be little point in recommending the minimum wage rates if these were not followed in practice.

**1.3** Because of this, establishing measures of non-compliance is equally important. We need to know if the problem is getting better or worse and if enforcement resources are targeted in the right place. Data limitations mean that understanding the level and trends of the issue is extremely challenging in practice. Nevertheless in this report we give our best estimate of the scale, nature and direction of travel of non-compliance in the UK.

**1.4** Before we do so it is important to set out some context. The introduction of the National Living Wage (NLW) in April 2016 had a substantial impact on the UK labour market. The hourly rate for those aged 25 and over rose by 10.8 per cent to £7.20 on an annual basis, the joint highest annual percentage increase in the minimum wage since its inception. This resulted in a sizable increase in coverage – the term we use to refer to those paid within 5 pence of one of the minimum wage rates or below – which increased substantially, from just over one million workers aged 25 and over to a little over 1.6 million, or from 5.6 per cent of the labour force to 7.3 per cent.

**1.5** But increases in pay were not limited to those who were at or close to the National Minimum Wage previously. Following the introduction of the NLW in April 2016, pay across the bottom quarter of the income distribution increased by more than the average. This amounts to 6 million workers and benefited those earning up to £9 per hour in 2015, far more than the initial £7.20 rate. At the same time younger workers also benefited from the increase in pay, up to 7 per cent of whom were lifted to or above the NLW (£7.20) following its introduction.

**1.6** Alongside the pay increases for workers and increased costs for employers the introduction of the NLW has a number of direct implications for non-compliance. Firstly, it is possible that, the higher rate will be relatively less affordable for some employers, meaning that some may seek to avoid it through non-compliance. Secondly, the significant increase in coverage means that there are

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more workers at risk of being underpaid. Essentially, HMRC now has the task – following the April 2017 upratings – of policing the pay of 2.3 million workers on one of the NMW rates instead of 1.5 million before the NLW's introduction. And this will rise further as the NLW moves towards 60 per cent of median earnings by 2020, potentially covering 3.3 million workers UK wide. It also means that some sectors and occupations, which had previously paid above the NMW, will now need to ensure they are compliant as the NLW catches up with them. This will include sectors such as security and call centres. Thirdly, the National Living Wage was introduced in the month of April, while previous upratings took place in October, creating the risk that employers would be caught out by the timing change. Fourth, it applied to a new age band - those aged 25 and over, creating a degree of greater complexity.

**1.7** The Government took action to mitigate these risks, including a National Living Wage communications campaign involving online, TV, press coverage and working with stakeholders, which had the explicit aim of ensuring employer compliance and raising worker awareness. Polling before and after the campaign showed that awareness of the £7.20 rate rose from 33 per cent to 80 per cent amongst workers and from 50 per cent to 84 per cent amongst employers. Awareness of the exact rates amongst both workers and employers is vital in reducing non-compliance, particularly unintentional non-compliance, and so this campaign is likely to have had a positive impact. However, the calling of the Election meant that this campaign was curtailed, albeit having operated for a substantive period. We return to this when we examine the scale and nature of non-compliance.

# 1. The nature and extent of non-compliance

## What is non-compliance?

**1.1** Non-compliance occurs when a worker is paid less than their legal entitlement - usually the headline hourly rate applicable for someone of their age, though there are also some cases where workers can legally be paid below it (for example, where employers who provide accommodation to workers are making deductions up to the daily level specified by the Accommodation Offset, the only benefit in kind allowable under the minimum wage).

**1.2** To simplify we can divide non-compliance into two categories: intentional and unintentional. In the former case employers are aware that they are underpaying and research evidence<sup>1</sup> tells us that they give a variety of rationalisations for this: it may be that they are self-consciously unscrupulous; it may be that their business is struggling and they say that they cannot afford it; they may blame competition from other businesses who they believe are non-compliant; in some cases they offer non-wage benefits, such as flexibility around hours/time of work, meals or travel which they believe compensates for any underpayment; some employers question why they should pay above this rate if workers are willing to work for less. At the most serious end intentional non-compliance involves organised crime and forced labour.

**1.3** It should be noted however that in practical terms it can be very difficult to distinguish between intentional and unintentional non-compliance. An unscrupulous employer is likely to claim that any non-compliance was unintentional. Equally, there is a grey area between unintentional and negligent. And, importantly, regardless of the intention, in all cases of non-compliance it is the worker who loses out.

**1.4** In cases of intentional non-compliance workers themselves may take no action: they neither raise it with their employer nor make a complaint via the main route for workers to seek redress, the telephone helpline run by the conciliation service and employment rights body ACAS. Again, there are a range of reported reasons for this in the available research<sup>2</sup>: they may be unaware that they are being underpaid or unaware of their rights; some report being worried about losing their job and/or falling out with their employer if they make a complaint; some do indeed value non-wage benefits over the NMW; others believe there is no point in complaining as they will simply end up in another low or under-paid job; others still are just not aware of the routes to complain or believe it will be a costly and lengthy process; finally, some may be claiming income contingent benefits in addition to their pay, and under-reporting the hours they work for example. In more serious cases employers

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<sup>1</sup> IPSOS MORI, 2012. *Non-compliance with the National Minimum Wage*. Research report prepared for the LPC.

<sup>2</sup> Department for Business, Innovation and Skills, 2014. National minimum wage: understanding the behaviour of workers on less than minimum wage. BIS/14/610.



deliberately make their staff complicit in the non-compliance by encouraging and helping them to claim benefits in this way.

**1.5** Unintentional non-compliance arises from a lack of awareness on the part of employers and employees or lack of understanding or carelessness around the NMW regulations. For example, employers may be slow to raise the pay of a worker whose recent birthday entitles them to a higher rate; other employers make deductions for costs relating to the job e.g. uniform or equipment costs which take pay below the NMW; similarly some deductions not connected to the job such as salary sacrifice schemes around childcare are also non-compliant if they take pay below the NMW.

**1.6** It is clear that the nature of non-compliance can vary significantly, but what is consistent is that it is very difficult to measure, not least intentional non-compliance where employers will actively seek to conceal their activities. Nevertheless, in the next section we present our estimates of the number of people affected.

## Estimates of the scale of non-compliance

**1.7** In previous reports we have mainly used the Annual Survey of Hours and Earnings (ASHE) to estimate the scale and nature of non-compliance. ASHE is the most detailed and comprehensive source of earnings information available and is based on a one per cent sample of all employees drawn from HM Revenue and Customs Pay As You Earn (PAYE) records. ASHE provides a proxy measure for non-compliance; we can estimate the percentage of workers who were paid below their age relevant rate at the time of the survey. However, this is not a true estimate of non-compliance as some underpayment is legitimate, for example because of the accommodation offset<sup>3</sup> (where employers can offset a certain amount of rent if they provide accommodation); commission and bonuses (which count towards the NMW but may not have been paid in the reference pay period); piece rates (where special arrangements exist) and apprentices (ASHE estimates of the number are much lower than from the admin records). Equally, some underpayment – for example resulting from deductions to pay through salary sacrifice – will not be shown in ASHE. And, as with any survey, there could be errors in the responses given to the questions.

**1.8** Furthermore, a critical limitation is that the ASHE does not cover the informal economy, where a significant share of non-compliance is likely to take place. An adjusted measure that removed cases legitimately paid below the applicable hourly rate and that took account of measurement error from rounding would be a lower-bound estimate of the scale of non-compliance: essentially quantifying the problem in the formal economy.

**1.9** Over many years the ASHE estimate of measured underpayment has been consistently flat, hovering below 1 per cent of workers aged 25 and above and between 1 and 2 per cent for younger workers once apprentices are accounted for. However, in our Autumn 2016 report, we showed that the number of underpaid workers had roughly doubled for those aged 25 and above from 154,000 to 305,600 between April 2015 and April 2016 (or from 0.6 per cent to 1.3 per cent of workers aged 25

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<sup>3</sup> Employers who provide accommodation to their staff can make deductions to pay that take it below the NMW subject to a maximum of £6.40 a day or £44.80 a week (these are the rates as of April 2017)

and above)<sup>4</sup>. Despite this increase, the percentage of workers affected appears relatively small as a proportion of the whole labour force.

**1.10** But there is a risk of downplaying the scale of underpayment amongst low-paid workers when measuring in this way. Throughout this report we consider what proportion of coverage – workers who are paid within 5p of the rates or below – are underpaid. By this measure almost 1 in 5 (19 per cent) low-paid workers aged 25 and above were underpaid at the time of the ASHE survey in 2016, up from 15 per cent the previous year.

**1.11** Between April 2015 and 2016 underpayment actually fell slightly for younger workers, from 1.6 to 1.5 per cent. While it appears to have increased as a share of coverage for younger workers – from 13.4 per cent to 15.5 per cent – this is because coverage itself fell, as many younger workers received a pay rise following the introduction of the NLW.

**1.12** At the time of writing the 2016 Autumn Report we were concerned by this apparent significant rise in underpayment, but were also aware that part of it may have been caused by timing issues. The ASHE takes place in the April of each year, which, under the previous NMW cycle, would have been 6 months after the introduction of the NMW rate(s) in the previous October – allowing plenty of time for the rates to ‘bed in’. But because the NLW was introduced on a different cycle – with upratings each April – the 2016 ASHE took place just a few weeks after the introduction of the NLW, meaning that the observed increase may be ‘frictional’ or temporary as employers take time to respond to the new rates. This may also explain the different trend for younger people – the April 2016 ASHE was measuring the impact of upratings to the youth rates after 6 months as normal – the NMW rates for younger workers had increased in October 2015 but remained unchanged in April 2016.

**1.13** To look at the timing issue in more detail we compare the annual ASHE survey with a similar measure of underpayment derived from the quarterly Labour Force Survey (LFS), which is a survey of households. The LFS allows us to monitor pay throughout the year, whereas ASHE is just April each year. The LFS includes more demographic data which are not covered in ASHE, but is a less reliable source – partly because of a smaller sample size but also because pay and hours data is self-reported and less accurate than these data in ASHE. The issues include incomplete earnings data, less accurate pay information provided through proxy responses, and errors whereby workers tend to round their hourly, weekly or monthly rates of pay to the nearest round figure. The LFS has a key advantage over the ASHE data in that it is a survey of households and so more likely to pick up people working in the informal economy, than a survey of businesses. The LFS<sup>5</sup> typically records higher coverage and underpayment figures. Overall we judge that it is a flawed measure of levels of minimum wage pay or non-compliance, but it is a consistent series over time, and has value as an indicator of trends. So it can be used in combination with ASHE to shed light on what is happening.

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4 In addition to the 305,600 underpaid there were 180,000 workers who appeared to be underpaid on the date of the survey, but whose pay period straddled the uprating date. As the minimum wage is only legally applicable from the beginning of the pay reference period that starts after an uprating, these cases are not technically underpaid in the survey and so were excluded from our analysis. However, a small qualitative follow up study by the ONS suggested that many of these workers were underpaid several months later. For this reason the 305,600 should be regarded as a lower bound estimate of underpayment in April 2016.

5 Within the LFS the stated hourly rate variable (HRRATE) is known to provide more accurate estimates of low pay than the derived hourly pay variable (HOURPAY) but the difficulty is that not all respondents give a stated hourly rate. To overcome this we use an imputation technique developed by the ONS with Southampton University whereby the values of hourly pay are imputed using nearest neighbour donation for those respondents who didn't provide one.

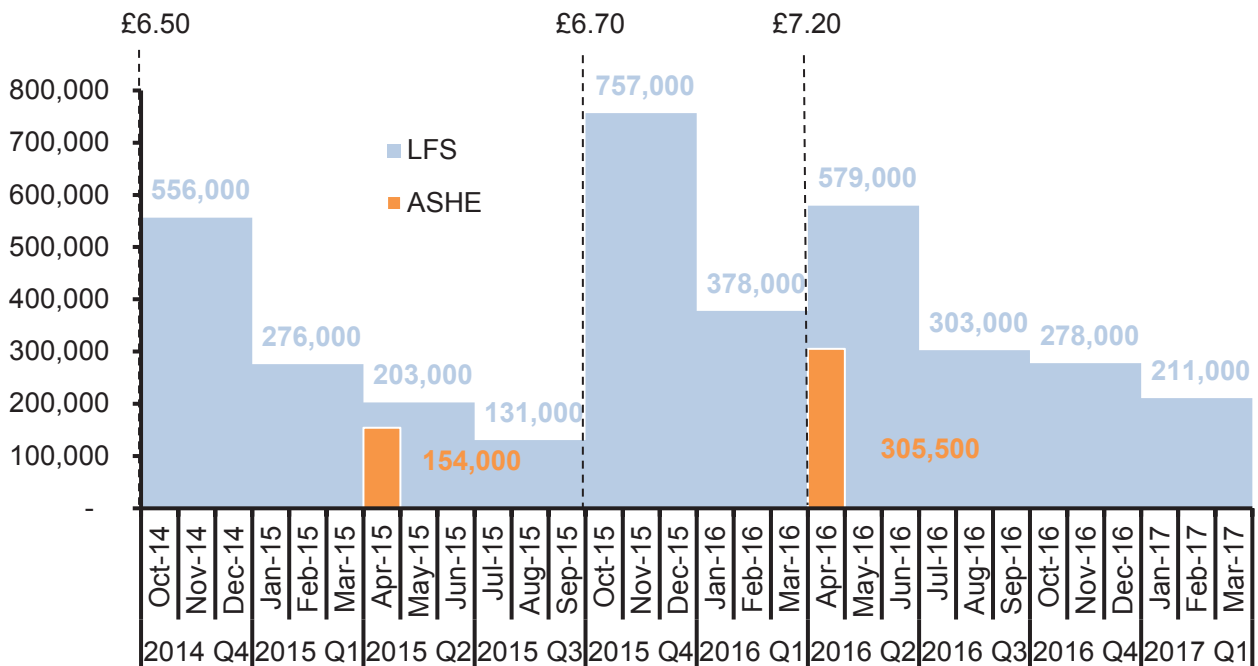
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**1.14** Figure 1 shows the ASHE measure of underpayment (in orange) and compares it to the LFS estimates (in blue), following each of the last three upratings, which are shown as dotted lines on the chart.

**1.15** There are a number of insights we can take from Figure 1. Firstly, LFS data illustrates the strong frictional nature of underpayment: the number of workers affected is at its highest immediately following each uprating, but then falls by around half in the six to nine months that follow. The large rise in underpayment as measured by ASHE in April 2016 was immediately after the uprating and corresponds to a similar spike in the LFS measure, suggesting the frictional effect is driving this. But interestingly, the LFS measure of underpayment was actually higher immediately following the October 2015 uprating (an increase of 3.1 per cent to £6.70) than it was following the introduction of the NLW. This may be because the NLW was high profile in nature and was accompanied by the Government’s aforementioned communications campaign, driving awareness and therefore compliance.

**1.16** The key question is: has underpayment increased as a result of the NLW? Our view is that the best way to answer this question is to compare LFS data from the fourth quarter of 2016 with the second quarter of 2015, as these both take place two quarters after an uprating, capturing persistent non-compliance. On this measure the number of underpaid workers aged 25 and over appears to have increased by around a third from 203,000 to 278,000. However, because the NLW resulted in a significant increase in coverage underpayment as a percentage of coverage appears to have fallen very slightly from 14 to 13 per cent – see Figure 2.

**Figure 1: Estimates of the number of underpaid workers aged 25 and over**

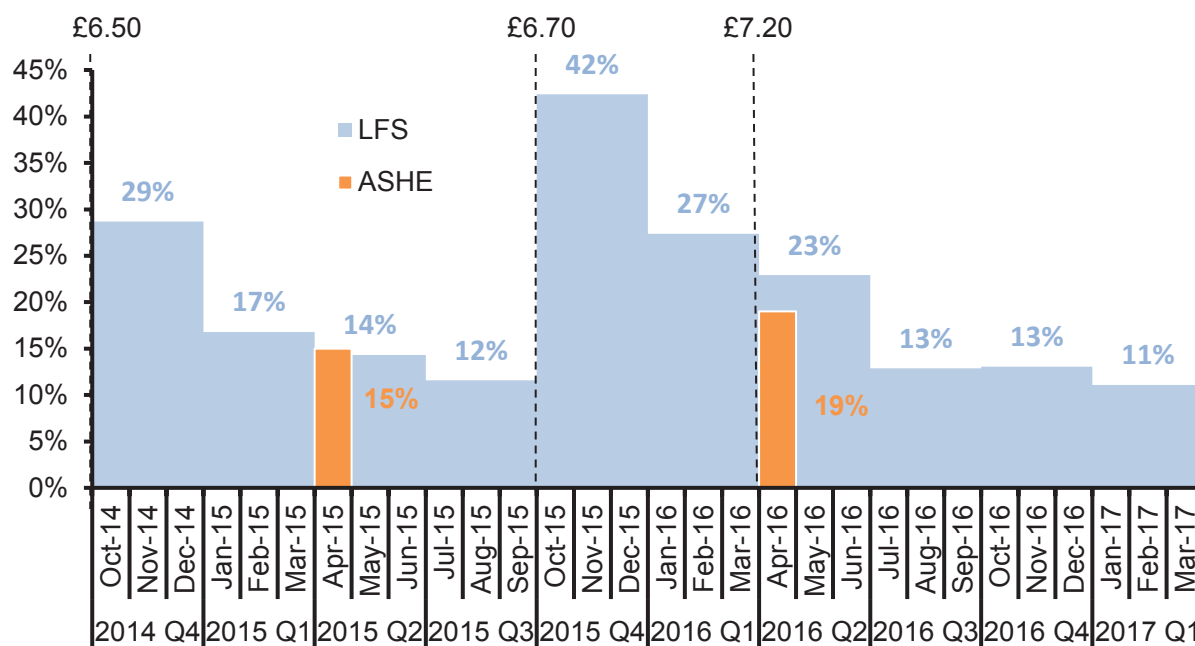


Source: LPC estimates using:

- a) Annual Survey of Hours and Earnings (ASHE), data excludes first year apprentices, UK
- b) Labour Force Survey Microdata, income weights, quarterly, not seasonally adjusted, UK

**1.17** Later in the year we will report on the changes to underpayment rates following the April 2017 uprating. This will form part of our annual report on the NMW and NLW rates. It will give a clearer picture on annual movements as the changes to upratings cycle will have ‘dropped out’ of the time series.

Figure 2: Estimates of underpayment as share of low-paid workers 2014 to 2016 for workers aged 25 and over



**1.18** As noted earlier ASHE does not provide a direct measure of non-compliance – nor does the LFS. ASHE does not cover the informal economy and is unlikely to reveal serious non-compliance as it is employers themselves who complete the survey. For this reason the underpayment uncovered by the ASHE data is more likely to be unintentional in nature. Indeed, this may partly explain the frictional aspect to underpayment that we have measured – employers realise their mistake and then raise their pay rates. We cannot establish from this data the extent to which these employers pay back forgone earnings.

**1.19** While the LFS is more likely to capture more of the informal economy, as it is a survey of workers, it is subject to other errors. These include incomplete earnings data and errors whereby workers tend to round their hourly, weekly or monthly rates of pay to the nearest round figure. Also, the figures shown here do not exclude apprentices and those who may have accommodation provided by their employer, and so should be taken as an upper bound estimate.

## Conclusion

**1.20** The overall conclusion is that measured underpayment remains a problem. Our best estimate suggests that, at its peak in the year, underpayment affects between 300,000 and 580,000 people. And while it has risen in the year following the introduction of the NLW, it has done so by less than might be expected given the increase in coverage. This is consistent with the evidence we heard from stakeholders, who hadn’t seen a significant increase in underpayment following the NLW’s introduction. Furthermore, and as the next section will show, there wasn’t a significant increase in workers complaining about underpayment to the ACAS helpline, the formal route for such complaints, following the NLW.

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**1.21** A key insight of our analysis is that, aside from the question of general level, there is a significant frictional element to recorded payment below the minimum wage which we urge policy makers to respond to. The good news is that the BEIS communications campaign that took place over the spring was appropriately timed to coincide with the rate changes to minimise the frictional element when the rates change. We urge Government to fully evaluate this communications campaign and, if it proves successful, consider repeating it each year. We also urge other measures to tackle the frictional element.

## 2. Groups and workers affected by underpayment

**2.1** Having looked at the overall picture for underpayment we now look at who it affects – who are the workers paid below the minimum wage? This is a critical for informing decisions around enforcement. This section analyses the underpaid population of workers to understand who is most likely to be affected. As with measuring trends over time, the available data presents significant limitations. We focus here on ASHE as the most authoritative source, recognising that it is a point in time measure covering underpayment at its peak in the year – the groups underpayment affects may change over the course of the year. Given that underpayment appears to be falling for younger workers the focus of this section is on workers aged 25 and above.

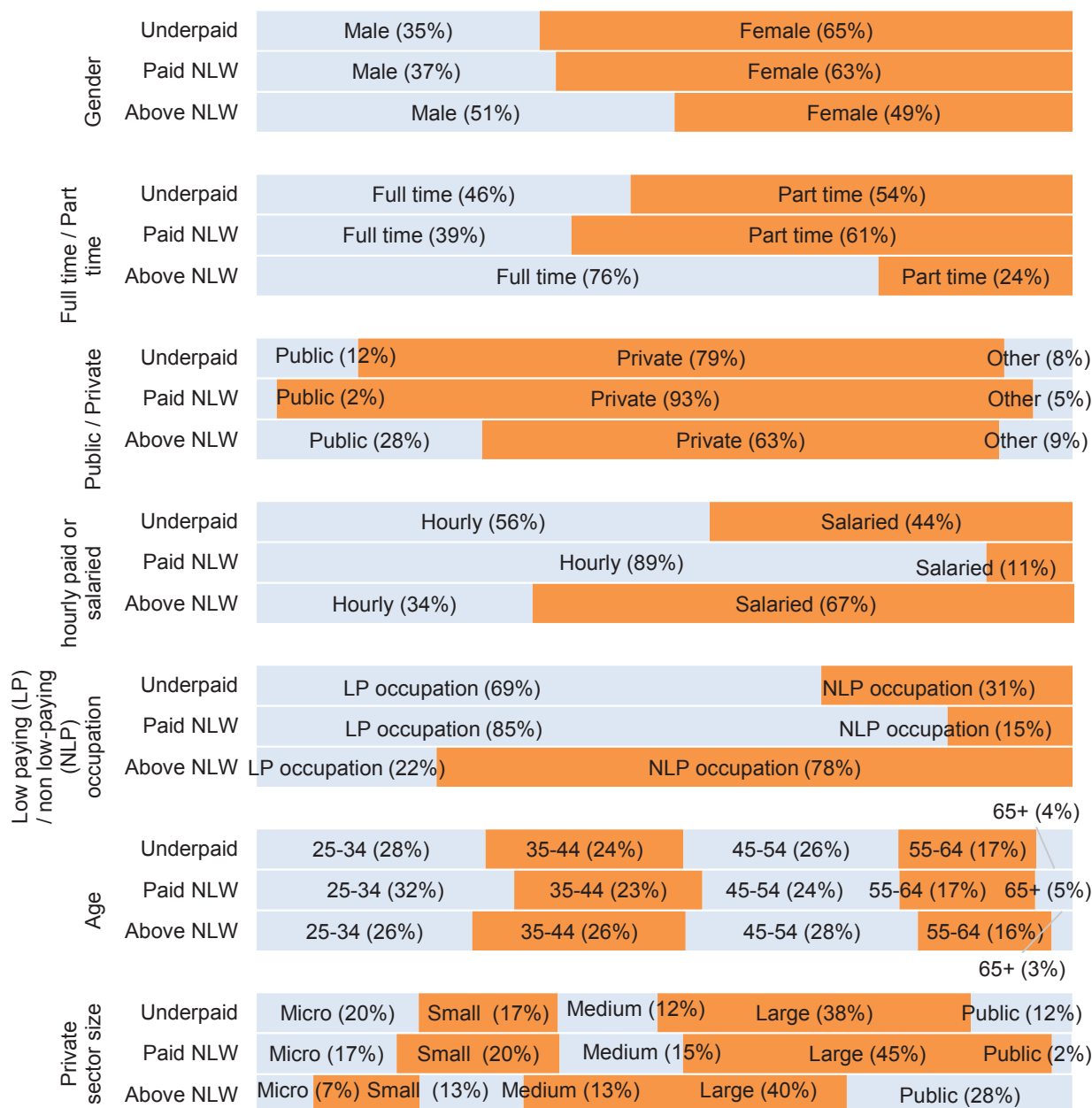
**2.2** Figure 3 shows a breakdown of three groups of workers; those who are underpaid, those paid the NLW, and those paid above it i.e. the rest of the employed workforce. Women make up most workers recorded in the data as paid below the minimum (65 per cent), but that is partly because a higher proportion of minimum wage workers are female (63 per cent). A similar picture is shown for part-time workers. Also, just two per cent of low-paid workers are in the public sector but make up 12 per cent of underpaid workers.

**2.3** The vast majority (89 per cent) of low-paid workers are paid by the hour, while workers paid above this are more likely to be salaried. However, underpaid workers have a different profile – just under half of them are salaried, suggesting that low-paid salaried workers are at particular risk of underpayment.

**2.4** Unsurprisingly, the vast majority (85 per cent) of low-paid workers are in traditionally low paying occupations. These include retail, hospitality and social care. But the picture is different for underpaid workers, a third of whom don't work in low paying occupations. Furthermore it is these underpaid workers who tend to be salaried as opposed to have an hourly rate.

**2.5** While those who work for large private sector employers (those with 250 staff or more) are less likely to be underpaid overall, the sheer volume of them in the UK labour market means they make up 38 of underpaid workers. The age profile of underpaid workers is very similar to all other workers.

**Figure 3: Breakdown of underpaid workers aged 25 and over (ASHE, 2016)**



Source: LPC estimates using Annual Survey of Hours and Earnings (ASHE), data excludes first year apprentices, UK

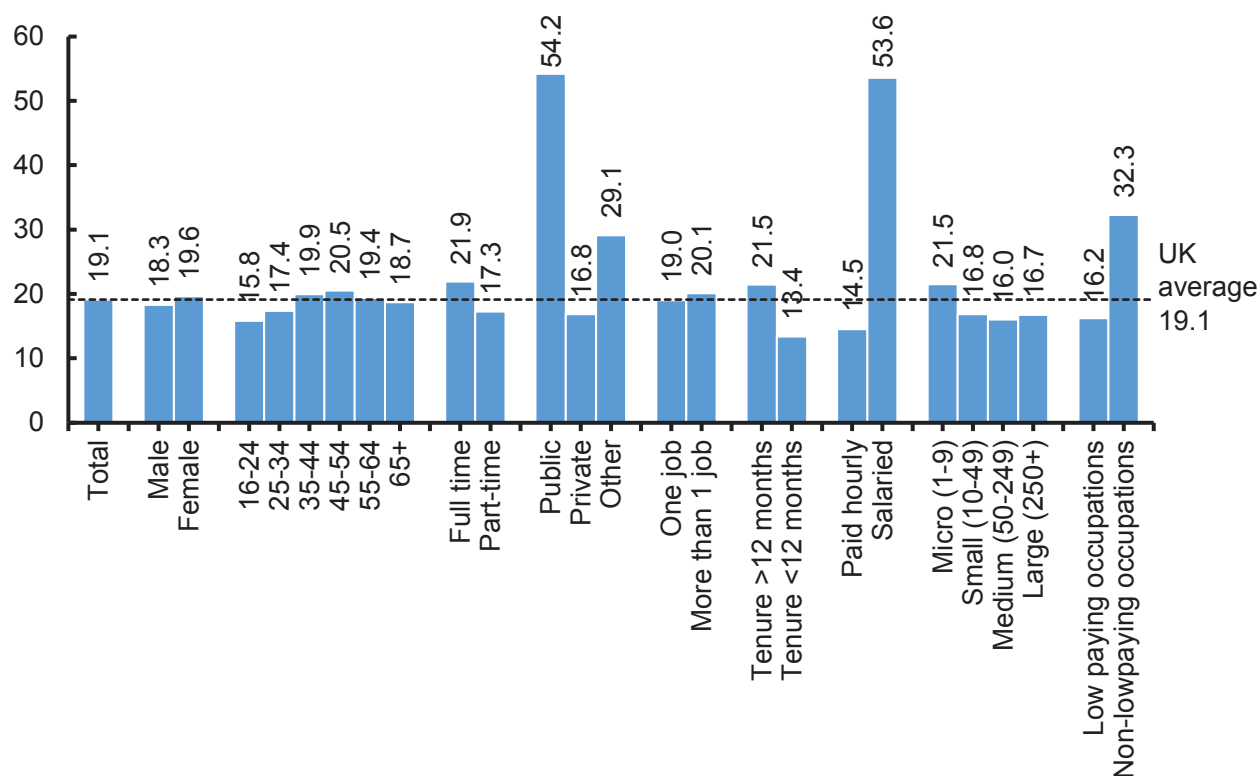
**2.6** Figure 3 covers job and personal characteristics of underpaid workers but tells us little about how the actual chances of being underpaid vary across those different characteristics - that's because there are large demographic differences in the proportion of different groups on the minimum wage. To take account of this, we can calculate underpayment rates as a share of all underpaid workers.

**2.7** Figure 4 shows the share of low-paid workers in each group who are underpaid for a range of different characteristics. Overall almost 1 in 5 low-paid workers aged 25 and over were underpaid in the ASHE survey in 2016. There is little difference in the rates between men and women or between different age groups. This seems counter intuitive, how can two thirds of underpaid workers be women but low-paid men and women have roughly the same chance of being underpaid? The answer is simply that many more women are in low-paid jobs (9 per cent of women

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compared to 5 per cent of men). There is little difference across different sized firms, although workers for the smallest have an above average chance of being underpaid.

Figure 4: Percentage of low-paid workers who are underpaid for various types of worker aged 25 and above (2016)



Source: LPC estimates using Annual Survey of Hours and Earnings (ASHE), data excludes first year apprentices, UK

**2.8** Instead the underpayment rates that stand out are those for the public sector, salaried workers and, again perhaps counter-intuitively, for those working in non-low paying occupations. Salaried workers are an issue that we have drawn attention to in previous reports. Perhaps because in some cases neither salaried workers nor their managers are keeping track of the hours they work and their hourly rate of pay, those at the lower paid end risk falling into non-compliance. Indeed, as part of our evidence gathering last year we heard anecdotal evidence of employers suddenly realising their management staff had been working very long hours and so needed to be sent home immediately to prevent them becoming non-compliant. Furthermore, previous qualitative research has shown examples of salaried workers thinking that they are not eligible. Given that salaried workers make up almost half of underpaid workers they are a group that may need further attention.

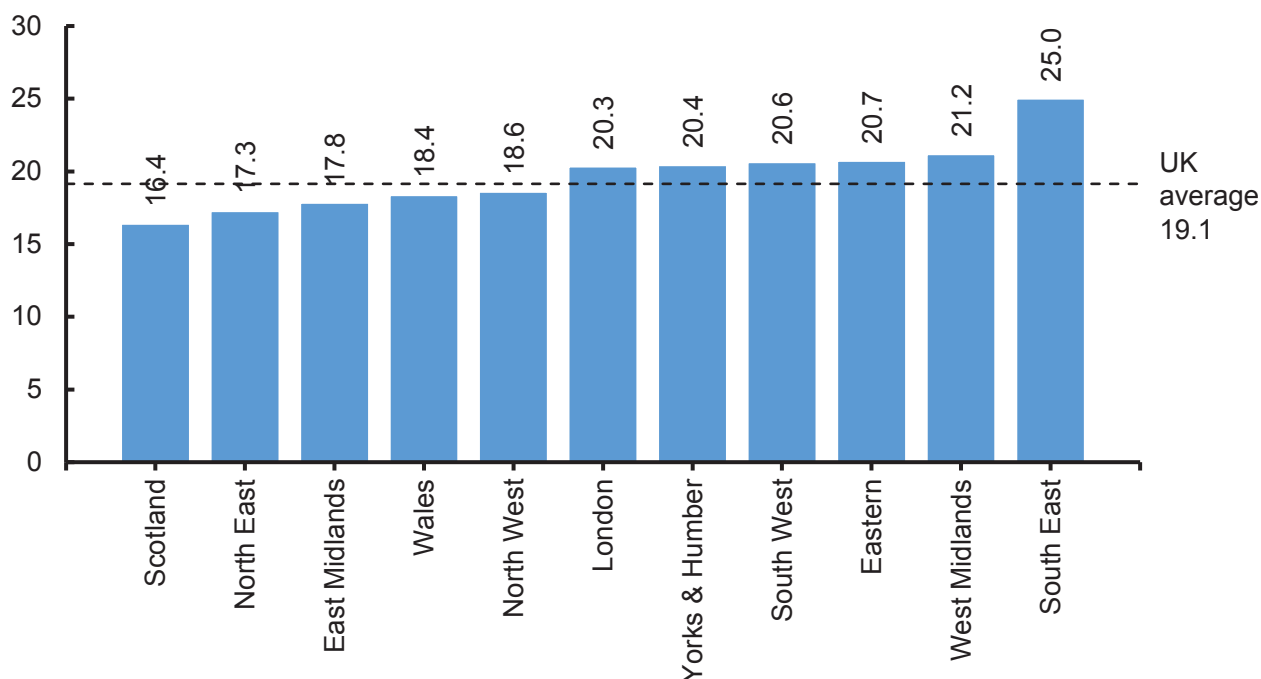
**2.9** The lower rate for low paying occupations is perhaps down to the fact that many more of these workers are paid hourly meaning that both they and their employers are more likely to be aware of any underpayment. Furthermore, coverage is much higher so the general awareness of the NMW and NLW will also be higher amongst both employers and employees in low-paying occupations.



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**2.10** The high rate in the public sector is harder to explain. Although it is possible that at least part of this is also down to the salaried worker issue. Also, it is important to remember that these workers tend to be better paid and so coverage is very low. Just 1 per cent of public sector workers are paid the NLW, compared to 9 per cent in the private sector. So underpayment as a share of coverage is a relatively high percentage of a very small group.

Figure 5: Underpayment rates by nation and region of the UK (workers aged 25 and above)



Source: LPC estimates using Annual Survey of Hours and Earnings (ASHE), data excludes first year apprentices, UK

**2.11** In geographical terms underpayment as a share of low-paid workers tends to be lower in areas where coverage is highest, for example the North East, East Midlands and Wales. This may be down to the fact that high coverage brings and greater levels of high awareness with it, perhaps because more low-paid workers are paid hourly, making the appropriate pay levels more visible. This may explain the high levels in the South East – because coverage is lower there are lower levels of awareness. The part of the UK that stands out is Scotland which has both low coverage and the lowest underpayment rate.

Figure 6: Underpayment rates for low-paying occupations (workers aged 25 and above)

	Low-paid workers	Share of workers paid NLW	Underpaid workers	Share of all underpaid workers	2016 Underpaid workers as a percentage of coverage
Childcare	49,100	17	16,600	5	34
Non Low-paying sectors	292,000	2	94,200	31	32
Transport	63,200	14	15,200	5	24
Office Work	43,600	12	9,400	3	22
Hospitality	237,300	32	46,600	15	20
Hairdressing	18,500	28	3,300	1	18
Social Care	104,700	16	18,000	6	17
Leisure	19,800	13	3,100	1	16
Cleaning	247,800	35	35,500	12	14
Retail	311,300	21	44,400	15	14
Storage	75,400	15	9,800	3	13
Non-food Processing	35,400	12	3,300	1	9
Agriculture	15,200	11	1,200	0	8
Food Processing	72,600	24	4,700	2	6
Textiles	10,500	21	400	0	3
<b>Total</b>	<b>1,596,300</b>	<b>9</b>	<b>305,600</b>	<b>100</b>	<b>19</b>

Source: LPC estimates using Annual Survey of Hours and Earnings (ASHE), data excludes first year apprentices, UK

**2.12** Figure 6 shows the rates of underpayment for the LPC’s designated low paying occupations, which are defined by the share of minimum wage workers in each sector. While there is significant variation in rates, the majority of low-paid occupations are below the average, including in retail, cleaning and hairdressing. Again, this is perhaps because these occupations have more workers who are paid hourly and more low-paid workers, both of which tend to lead to greater awareness of the appropriate pay rates. The occupations where under-payment appears highest are childcare, transport and office work, although these only account for 13 per cent of underpaid workers. Rates are at their lowest in textiles, food processing and agriculture. However, the caveats to the data should be reiterated here, particularly the lack of coverage of the informal labour market and small cell sizes for some areas of the economy, which is likely to impact on the figures for some occupations more than others.

**2.13** The occupational category that deserves attention is that of non-low paying occupations – this group includes all those underpaid workers who do not work in occupations that meet the LPC criteria for being low paid. Unsurprisingly, the share of all workers in these occupations who are underpaid is low, but as a share of coverage it is very high. It is second only to childcare, and accounts for just under a third of underpaid workers (31 per cent). This presents a challenge for enforcement policy as this group represents a significant piece of the problem but is spread across a wide range of occupations.

**2.14** To shed light on this group we have conducted further analysis and found a number of occupations with high rates of non-compliance. These include Education Support Assistants, Teaching Assistants and Nursing Auxiliaries alongside various administrative occupations.

## **Conclusion**

**2.15** The majority of underpaid workers are female, part-time and hourly paid, but this is driven by coverage. While their overall chances of being underpaid are relatively low the sheer abundance of workers for the largest private sector employers means that they make up a considerable proportion of underpaid workers. In the next section we show that the HMRC's additional resources have been targeting larger employers in an effort to tackle these cases, which can often be more complex in nature.

**2.16** Finally, it is salaried workers and those in non-low paying occupations that are perhaps worthy of more attention. Salaried workers are perhaps less likely to be aware that they are being underpaid because neither they nor their employer are checking their hourly rate. Work to inform this group would be helpful in tackling underpayment here. Underpayment in non-low paying occupations is a challenge because it is difficult to target.

## 3. The policy response to minimum wage non-compliance

**3.1** BEIS is responsible for minimum wage compliance and enforcement policy and HMRC enforces the NMW Act on BEIS's behalf via a service level agreement. The current policy has three strands: HMRC investigating all complaints from workers to the ACAS helpline; HMRC undertaking pro-active investigations; and communications activities aimed at raising awareness amongst both workers and employers. The latter consists of, for example, the BEIS-led NLW awareness campaign carried out in Spring 2017 and the regular naming rounds, alongside more employer focussed 'promote' activities conducted by HMRC

**3.2** There has been ongoing progress in non-compliance policy over recent years, specifically the significant expansion of the resources available and an increased use of certain policy levers, including increased naming of employers found to underpay and increases in the maximum penalty. This progress is likely to continue as January 2017 saw the formal announcement of Sir David Metcalf as the new role of Director of Labour Market Enforcement (DLME). Sir David will set the strategic priorities for all employment enforcement bodies, gather intelligence and identify vulnerable sectors and regions to inform the most effective response. He published his initial report in July 2017. The LPC looks forward to working with the DLME as his full strategy, which is due out in Spring 2018, develops. Indeed, we hope that he and his team will consider the recommendations we make in this report when writing their strategy.

### Resources

**3.3** In this chapter we consider the current non-compliance policy response, looking at resources first of all. Recently, the budget has increased several times and is set to increase further. Over the four years from 2009/10 to 2013/14 HMRC's budget was around £8 million, it was then increased to £13 million in 2015/16, to £20 million in 2016/17 and will rise again to £25 million for the three years from 2017/18 onwards.

**3.4** HMRC tell us that these extra resources are being used to hire more investigating officers, which in turn allows them to take on more proactive investigations, including of larger and more complex cases, and conclude them in a shorter time. There are now 399 enforcement officers, up from 237 in 2015/16.

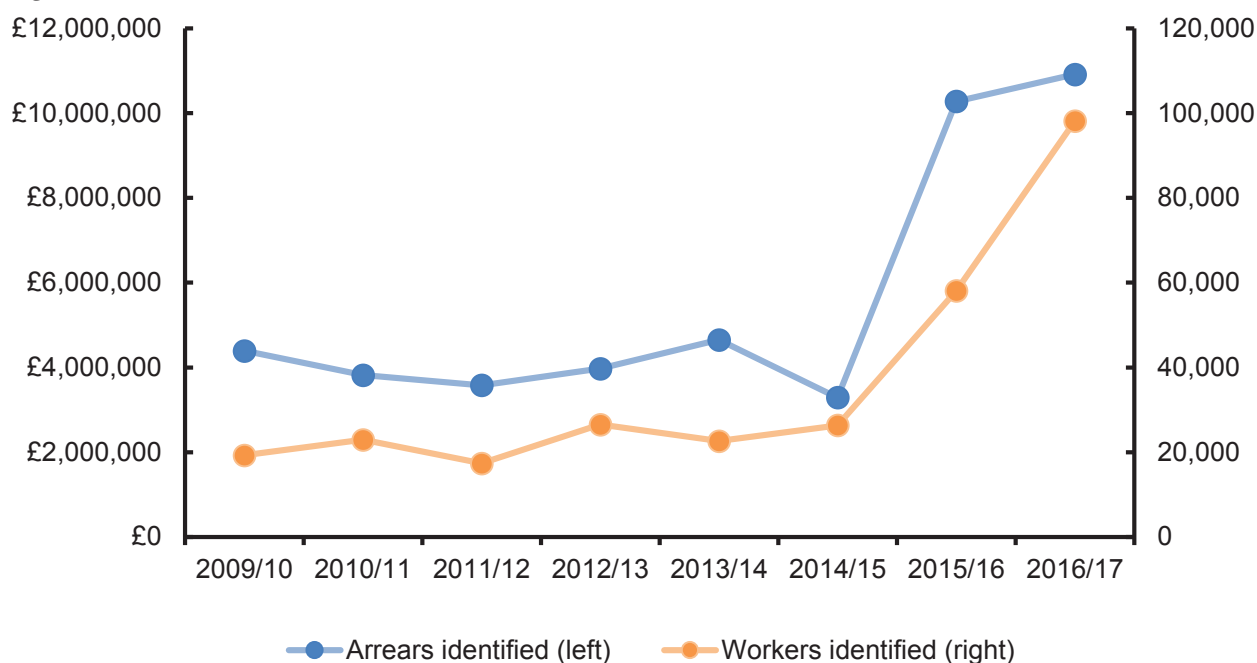
**3.5** All of our stakeholders agree that more resources are welcome, as is the commitment of an increase into the medium term, but we have yet to see if these are sufficient to tackle non-compliance as coverage of the NLW increases up to 2020. Nevertheless, increases in resources combined with the appointment of the Director of Labour Market Enforcement are promising developments.

## Enforcement activity

**3.6** HMRC and BEIS provide the LPC with a range of data on their enforcement activities – this includes the number of cases that they have closed in each financial year, what share of them have successfully identified arrears in worker pay, the size of those arrears and the number of workers affected. The time series data is based on when the case was closed, not when the underpayment took place which, in some cases may have been several years ago or indeed have taken place over several years.

**3.7** Figure 7 shows that the number of workers for whom HMRC have found arrears more than doubled in 2015/16 to 58,000 and increased again to a record 98,000 in 2016/17 from an average of around 25,000 workers per year over the preceding six years. Arrears increased by a similar margin, from around £4 million per year over 2009/10 to 2014/15 to just over £10 million in 2015/16 and 2016/17.

Figure 7: Total arrears identified and total workers identified in HMRC enforcement



Source: LPC analysis using BEIS data from "National Minimum Wage: Government evidence to the LPC"  
<https://www.gov.uk/government/collections/national-minimum-wage#government-evidence-to-the-lpc>

**3.8** This increase in workers and arrears identified appears to be down to greater use of the tools of enforcement for HMRC as opposed to a sudden increase in underpayment. The previous chapter showed that while underpayment did rise following the NLW it did so by less than might be expected given the significant rise in the number of people who became eligible for the NLW. Furthermore, the number of complaints to the ACAS helpline in the year following the introduction of the NLW helpline was very similar to year before.

**3.9** However, HMRC's expanded resources have not led to a significant rise in the volume of cases they investigate. In 2016/17 HMRC closed 2,674 cases, up from 1,455 three years previously, but at around the same level as 2009/10 to 2011/12. Instead it is the character of the cases investigated that has changed. HMRC is now taking on much larger and more complex cases. Just 15 cases accounted for £6.8 million in arrears and 78,000 workers in 2016/17 - the lion's share. This is a marked increase in the number of these larger cases – where arrears are over £100,000 –

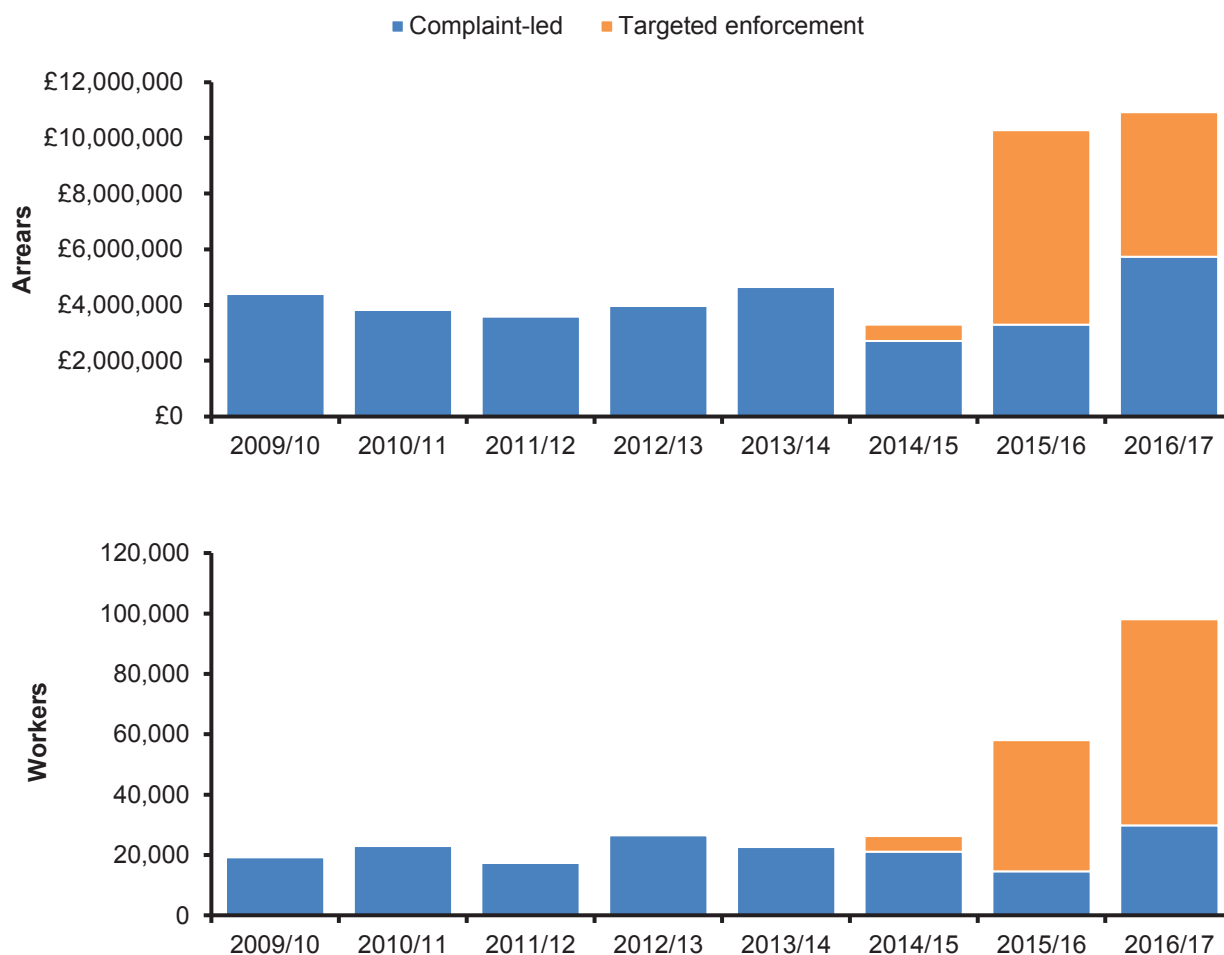
## Low Pay Commission: Non-compliance and enforcement of the National Minimum Wage

being closed. In previous years HMRC had tended to close between 3 and 6 cases of this size. And this increase is set to continue, as of May of this year HMRC has opened cases into 38 large businesses in priority sectors. Again, this is welcome as the first chapter of this report showed that a significant share of underpaid workers work in large organisations.

**3.10** The balance has also shifted away from complaint-led cases and towards more proactive investigations. The latter now make up just under half of cases investigated, while a few years ago the vast bulk of cases were complaint led. These targeted enforcement cases account for the main increase in workers and arrears identified in 2015/16 and 2016/17.

**3.11** Also important to the boost in performance figures has been the introduction of ‘self-correction’ whereby HMRC can require an employer who has been found to underpay to check if any of their other current or ex-employees have also been underpaid. This allows further arrears to be identified but frees up HMRC resources to focus on other cases. Self-correction accounted for £6 million in arrears in 2016/17 or 55 per cent of the total identified.

Figure 8: Total arrears and workers identified in cases by complaint led and targeted enforcement cases



Source: LPC analysis using BEIS data from “National Minimum Wage: Government evidence to the LPC”  
<https://www.gov.uk/government/collections/national-minimum-wage#government-evidence-to-the-lpc>

**3.12** We heard mixed evidence from our stakeholders on self-correction. While most agreed that the most important thing was for workers to be paid the correct amount and receive any arrears as soon as possible, others were concerned that in some cases employers were ‘let off the hook’. Others were concerned that workers may not be in a position to check if their self-corrected arrears

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are correct or if HMRC's checks to see if self-corrected arrears were actually paid are sufficient. It is clear that self-correction has helped identify significant additional arrears for many thousands of workers

**3.13** In summary then the improvement in HMRC's performance in tackling minimum wage non-compliance has come from the shift to targeted enforcement with larger employers, but particularly from self-correction. But there is one final dimension, the increases in arrears and workers have come from particular parts of the economy. The majority (70,000) of the 98,000 workers identified in 2016/17 were from the retail sector. According to our ASHE estimates, retail accounts for just 15 per cent of underpaid workers.

**3.14** Figure 9 shows how the arrears and workers identified in cases over the last three years are distributed across the economy. As might be expected the bulk of the arrears and workers have been in sectors that have a lot of low-paid workers. In the first chapter we noted that around one third of underpaid workers are not in traditional low paying sectors or occupations and in the enforcement data there are sectors where activity has been minimal in terms of identifying underpaid workers. We estimate that there may be over 100,000 underpaid workers across the education, professional, scientific and technical activities, manufacturing, construction, transport and the arts. And yet there have been just 3,000 workers identified in these in these sectors in HMRC's cases in 2016/17. We would urge HMRC to ensure that they are tackling non-compliance across a broad range of sectors.

**Figure 9: Total number of workers identified and arrears identified in HMRC cases**

Sector	Arrears			Workers		
	14/15	15/16	16/17	14/15	15/16	16/17
Finance	£21,300	£19,200	£3,041	84	17	9
IT/communication	£49,200	£19,900	£17,967	38	292	17
Real Estate Activities	£72,600	£56,800	£47,669	125	31	52
Construction	£110,700	£127,300	£112,618	121	90	94
Education	£132,100	£237,100	£69,886	336	214	180
Arts/Entertainment	£183,400	£597,800	£44,459	448	4,783	202
Other	£53,000	£49,600	£106,576	59	484	481
Transportation/Storage	£79,700	£22,200	£76,005	98	42	676
Manufacturing	£217,100	£77,500	£110,661	361	113	691
Profess/Sci/Tech	£37,200	£162,700	£152,798	36	4,218	1,231
Other Services	£376,400	£327,800	£717,633	367	959	1,376
Hospitality	£385,300	£1,419,700	£1,186,660	4,099	4,219	5,140
Admin & Support	£273,200	£4,747,800	£1,612,770	3,421	16,071	8,215
Health & Social Work	£904,400	£750,700	£2,869,948	12,157	2,562	9,363
Wholesale/Retail	£395,700	£1,665,100	£3,870,956	4,568	23,985	70,867
<b>Total</b>	<b>£3,291,300</b>	<b>£10,281,200</b>	<b>£10,999,647</b>	<b>26,318</b>	<b>58,080</b>	<b>98,594</b>

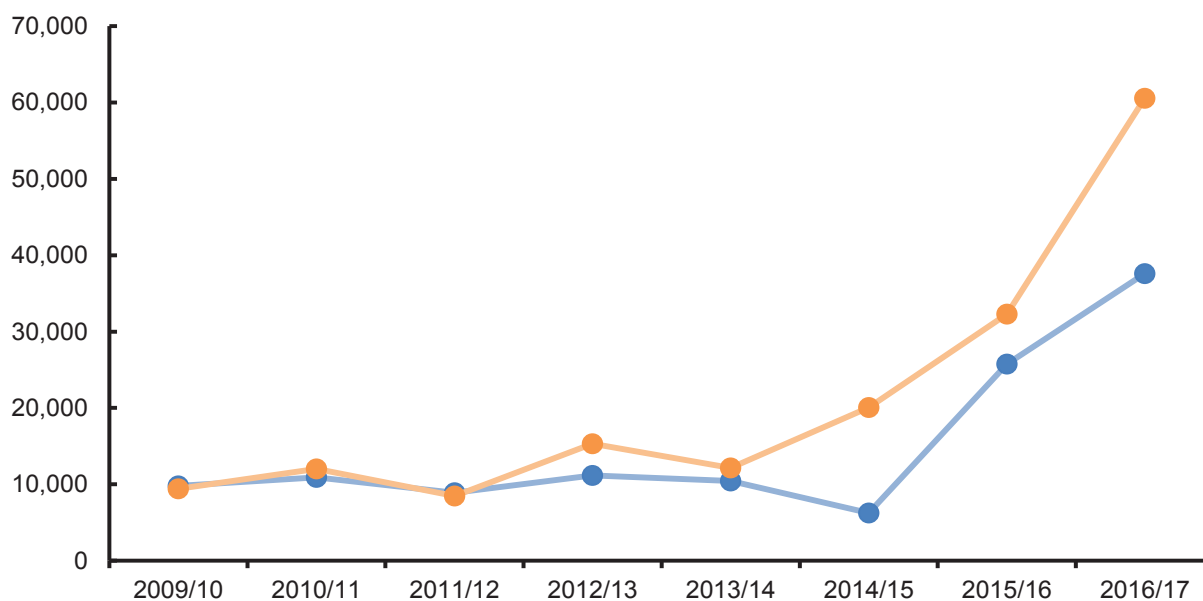
Source: LPC analysis using BEIS data from "National Minimum Wage: Government evidence to the LPC"  
<https://www.gov.uk/government/collections/national-minimum-wage#government-evidence-to-the-lpc>

## Enforcement activity by gender

**3.15** In the previous chapter our estimates of underpaid workers suggested that underpaid workers were more likely to be female than male. While this is driven by the fact that women are more likely to work in low paying jobs - coverage is 9 per cent for women but 5 per cent for men - it is important to establish if the balance of workers identified in HMRC cases is similar to our estimates of underpayment. This is notwithstanding the flaws in our estimates, particularly the lack of insight into informal working.

**3.16** Figure 10 shows the gender breakdown amongst workers identified by HMRC over the last seven financial years. As can be seen underpaid female workers outnumber males, making up 62 per cent of the total in 2016/17. This is very close to the balance we found in our estimates of underpayment using the ASHE, where women made up 65 per cent of underpaid workers. Previous qualitative research has shown that women may be less likely to act on their underpayment by making enquiries or a complaint, and this was the case in 2016/17 where women made up 56 per cent of enquiries to ACAS. This suggests that the increase in both self-correction and proactive investigations is helping to redress the balance somewhat. We would urge Government to continue to monitor the impact of non-compliance policy by gender and try to encourage more NMW complaints from underpaid female workers.

Figure 10: Gender of workers identified in HMRC enforcement cases



Source: LPC analysis using data from "National Minimum Wage: Government evidence to the LPC"  
<https://www.gov.uk/government/collections/national-minimum-wage#government-evidence-to-the-lpc>

## Penalties

**3.17** Penalties are a key part of the enforcement scheme; making sure that underpaying employers are suitably rebuked and acting as a deterrent to other employers. The penalty scheme has changed several times in recent years, raising the amount that employers can be fined each time. Under the current rules if the level of arrears for a particular worker is less than £100 then a minimum penalty of £100 applies, beyond this the employer pays a penalty equivalent to 200 per cent of the arrears up to a maximum of £20,000 per worker, in addition to paying the worker back at current minimum wage rates.

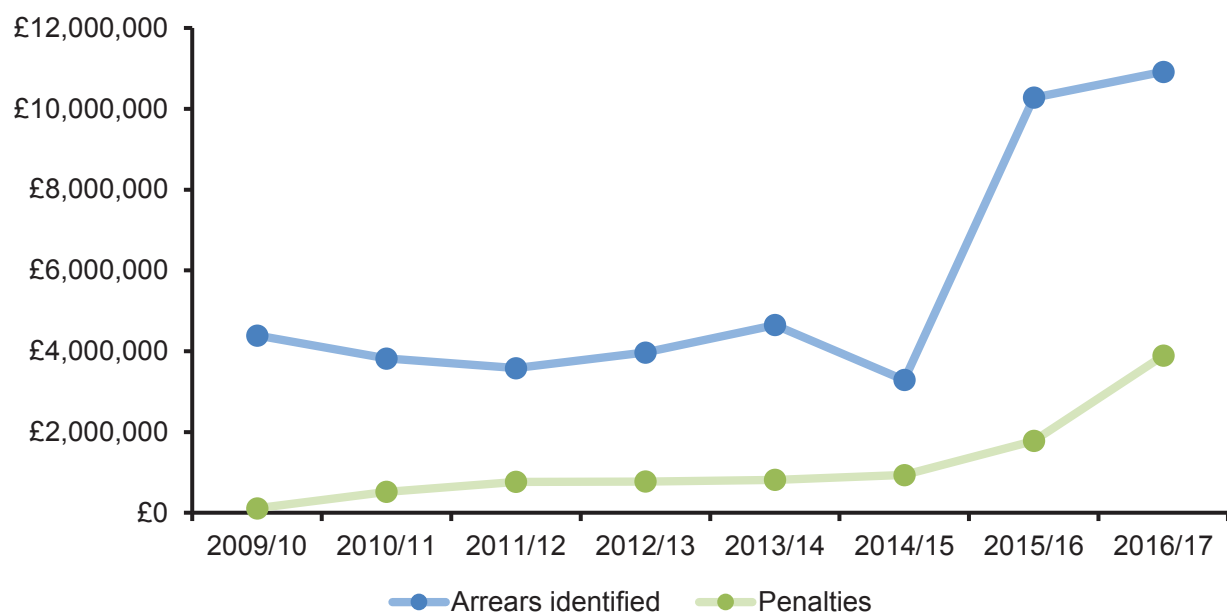


Figure 11: Penalties for minimum wage underpayment

Time of pay reference period in which NoU was issued	Penalty as a percentage of arrears	Penalty cap
Pre 7 March 2014	50%	£5000 per employer
Between 7 March 2014 and 25 May 2015	100%	£20,000 per worker (implemented through HMRC issuing multiple NOUs)
Between 26 May 2015 and 1 April 2016	100%	£20,000 per worker
Post 1 April 2016	200%	£20,000 per worker

**3.18** Figure 12 compares the level of arrears to the level of penalties. Arrears more than tripled from £3.3 million in 2014/15 to £10.9 million in 2016/17. And while the level of penalties also increased significantly it remains well below the level of arrears at £3.9m, despite the increases to the penalty ceilings. Again, a large part of this gap is down to self-correction as self-corrected arrears do not attract a penalty. Nevertheless, penalties awarded in 2016/17 are over a third of the total arrears – the highest proportion on record, and the average size of the penalty has increased dramatically over the years, from £292 in 2009/10 to £4,700 in 2016/17. We will return to this issue next year to examine the impact of the increased fee threshold in April 2016.

Fig 12: Total arrears and penalties for employers



Source: LPC analysis using data from “National Minimum Wage: Government evidence to the LPC” <https://www.gov.uk/government/collections/national-minimum-wage#government-evidence-to-the-lpc>

## Use of prosecutions

**3.19** Current Government thinking is that the civil powers – including penalties and naming – are sufficient in most cases of non compliance, but there is the option of criminal prosecution for more serious cases. BEIS’s policy is that prosecution is appropriate where employers are persistently non-compliant and refuse to cooperate with compliance officers during an investigation. Use of prosecutions is limited: there have been just thirteen successful cases since 2007.

**3.20** The LPC’s view has always been and remains that prosecutions are a very powerful deterrent and that they are currently underused. This is notwithstanding the fact that we understand the demanding criteria needed to be satisfied to bring a prosecution. We are also aware that the cost of

bringing such cases is estimated to be £50,000 on average<sup>6</sup> and that not only do workers have to wait longer to get their money back they do not always receive the same financial recompense as if they went down the civil route – the courts can take an employer’s ability to pay into account before setting the penalty.

**3.21** Nevertheless the LPC’s view is that there is scope to both increase the number of prosecutions and better publicise the ones that do take place. For example, four of the thirteen prosecutions were in the 2016 calendar year, but were not well publicised.

## **Awareness raising**

**3.22** Maintaining a high level of awareness of the rates of the National Minimum Wage and the basic conditions for eligibility are vital for reducing non-compliance. In our previous work on non-compliance we have called for the Government to raise awareness through communications campaigns and improved guidance.

**3.23** We have already noted the apparent success of the campaign to inform employers and workers about the introduction of the NLW in April 2016; our analysis of measured underpayment suggests – though does not prove – that this campaign may have reduced the frictional aspect of underpayment. As such there are grounds for the Government to repeat this exercise and be even more ambitious and targeted in their efforts. Therefore the LPC was pleased that the Government decided to undertake a £1.8m communications campaign around the April 2017 uprating. This campaign included a range of activities, including the largest ever naming round – which we examine in more depth in the next section – and was focussed on the 16 largest cities in the country and particular groups who are more likely to be underpaid and/or less likely to complain.

**3.24** It is unclear yet what impact this campaign has had although it has seen good coverage in both the national and local press, this is particularly the case for the naming round in February 2017. However, polling for the campaign also uncovered low levels of awareness with aspects of NMW compliance policy. For instance, it found that just half of workers earning under £15,000 were clear that tips cannot be used to ‘top-up’ pay to the legal minimum and that employers cannot deduct the cost of uniforms from pay if it takes it below the NMW. Only a third knew for certain that they should be paid for travel in between work appointments. Further, almost half did not know that they could legally claim their lost earnings back. This adds further weight to the need for on-going communications exercises to raise awareness further.

**3.25** In addition to the broader communications work led by BEIS, HMRC now also have a ‘promote’ strategy and team in place. This team undertakes a wide range of activities that all involve direct communications with employers – focussing on digital channels – aiming to encourage compliance. Examples of work here include: joint working with a range of stakeholders including the TUC, ACAS and employer trade bodies to produce additional guidance and provide webinars for employers; randomised controlled trials of ‘nudge’ letters – in one case to 670,000 employers – that encourage employers to check the rates and see if they are compliant; writing to employers who

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<sup>6</sup> <https://hansard.parliament.uk/Commons/2016-09-08/debates/ce8e1834-f639-4f2a-a639-88e5b6ff0390/DraftNationalMinimumWage%28Amendment%29%28No2%29Regulations2016?highlight=%22an%20issue%20that%20causes%20me%20concern%22#contribution-F24284D5-6091-496D-BF87-8F42DC796D1A>

appear to be advertising non-compliant jobs and/or unpaid internships online; and producing guidance in a range of languages to raise awareness among recent migrants.

**3.26** The LPC welcomes this focus on both broad awareness raising activity with specific actions to communicate with employers and calls on the Government to fully evaluate this activity and expand and repeat those actions found to be the most effective.

**3.27** In addition HMRC can build on its work to identify underpaying employers through online adverts. HMRC should consider establishing systems to search online and send out 'nudge' letters automatically to those employers and recruitment agencies that appear to be advertising non-compliant jobs. This could include work with DWP's Universal Jobmatch team to identify non-compliant vacancies.

## Numbers of complaints from workers

**3.28** In general complaint volumes are low in comparison to our estimates of the scale of the problem. In 2016/17 there were 4,660<sup>7</sup> enquiries to the ACAS helpline about underpayment of the National Minimum Wage, this was little changed from the previous year. Although we note that a larger share of enquiries have been referred on from ACAS to HMRC in 2016/17, which is likely to lead to an increase in the number of complaint led cases closed in the 2017/18 financial year.

**3.29** These are low numbers in comparison to our estimate of between 300,000 and 580,000 people affected at the peak point in the year. Paragraph 1.9 described the many reasons why underpaid individuals may not take any action, but nevertheless there should still be a clear policy approach aimed at getting more underpaid workers to complain. It also underlines the importance of pro-active investigations in addition to a complaint led approach.

**3.30** One positive development recently implemented is the new online complaint form, which was introduced at the beginning of 2017. This has the advantage of being accessible at any time of day 365 days a year. It is too soon to assess its impact but HMRC are seeing significant numbers of complaints via the online form, which are leading to identification of arrears, but without a parallel fall in calls to ACAS – suggesting that these are additional complaints.

## Naming employers found to underpay

**3.31** A key plank of the Government's efforts to both raise awareness and discourage underpayment is naming, whereby all employers for which an underpayment has been identified by HMRC are publicly named. There are circumstances whereby an employer is not named: if there is a national security risk, naming would be not in the public interest, or if there is a risk of personal harm.

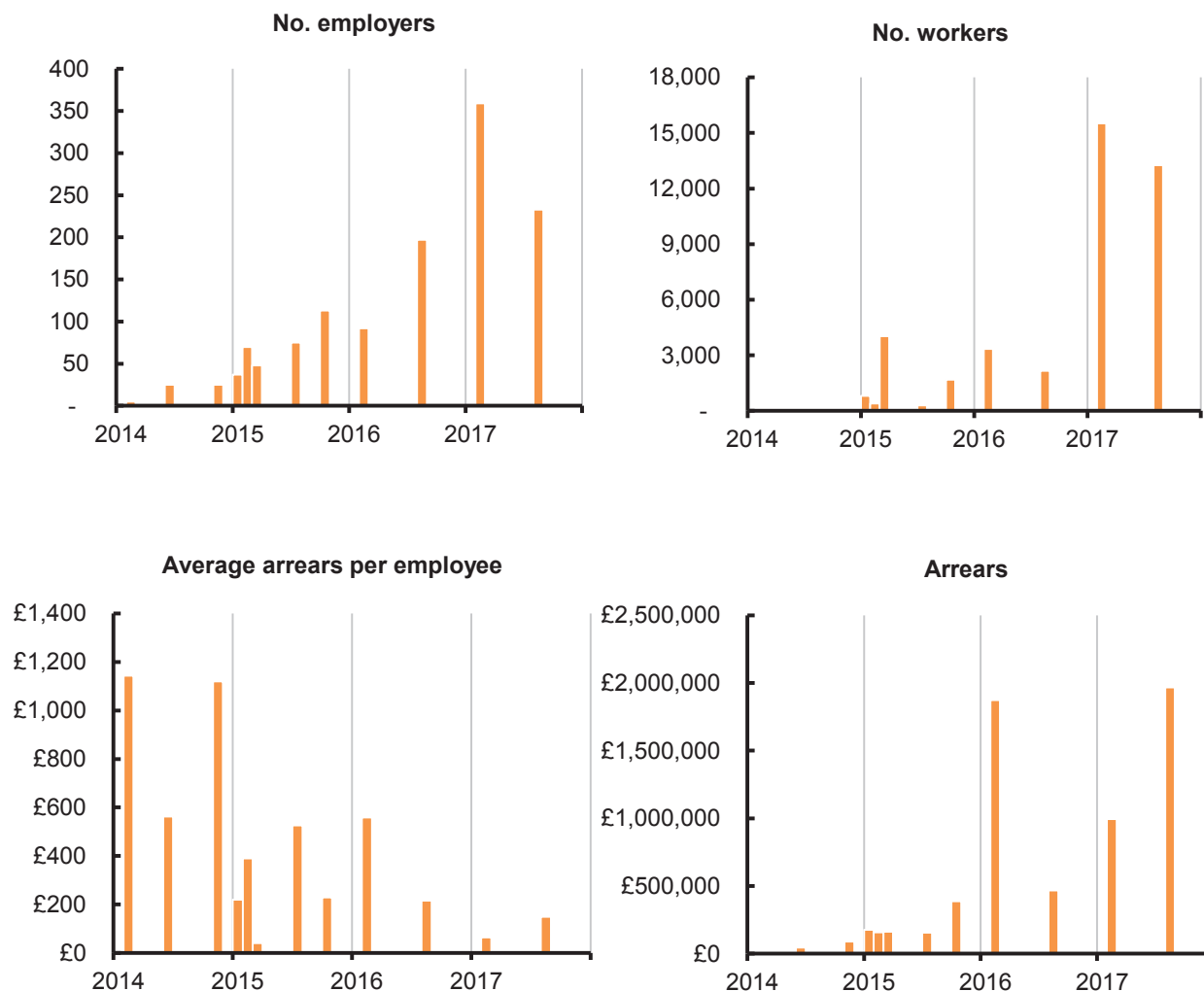
**3.32** The policy was first introduced at the beginning of 2011 but was little used until the criteria for naming were significantly changed in October 2013. Since then it has been used far more and Figure 13 shows how it has evolved over each naming round since the first in February 2014. Since then over 1,200 employers have been named (1,279, with arrears of £6.5 million owed to 42,000

<sup>7</sup> BEIS, 2017. *National minimum wage: government evidence to the Low Pay Commission on compliance and enforcement*, table 3

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workers. The top left panel in figure 13 shows the number of employers named in each round. This has grown steadily from just 5 in the first round in February 2014 to 233 in the most recent in August 2017. The largest round so far was the February 2017 round where 359 employers were named.

Figure 13: Employers, workers and arrears involved with naming cases by naming round



Source: LPC analysis of BEIS published naming cases

**3.33** The number of workers (top right panel of Figure 13) identified in naming cases has varied slightly more, but the two most recent rounds identified by far the most. Each identified over 13,000 workers, and in both instances this was driven by just one case. In February Debenhams were named for arrears of £135,000 for 11,800 workers, making up 76 per cent of workers identified in this round. In August Argos were named for underpaying 12,200 workers £1.5 million.

**3.34** The total amount of arrears identified has also steadily increased across rounds. The spike in arrears in the February 2016 round was also down to just one case: TSS Security services, which involved £1.7m in arrears owed to 2,519 workers. The TSS and Argos cases are by far the largest in arrears terms of all those named so far, they account for 49 per cent of arrears connected to naming cases. To put this into further context the next largest case is that of Debenhams but the arrears in that case, at £135,000, are less than 10 per cent of those owed by TSS Security.

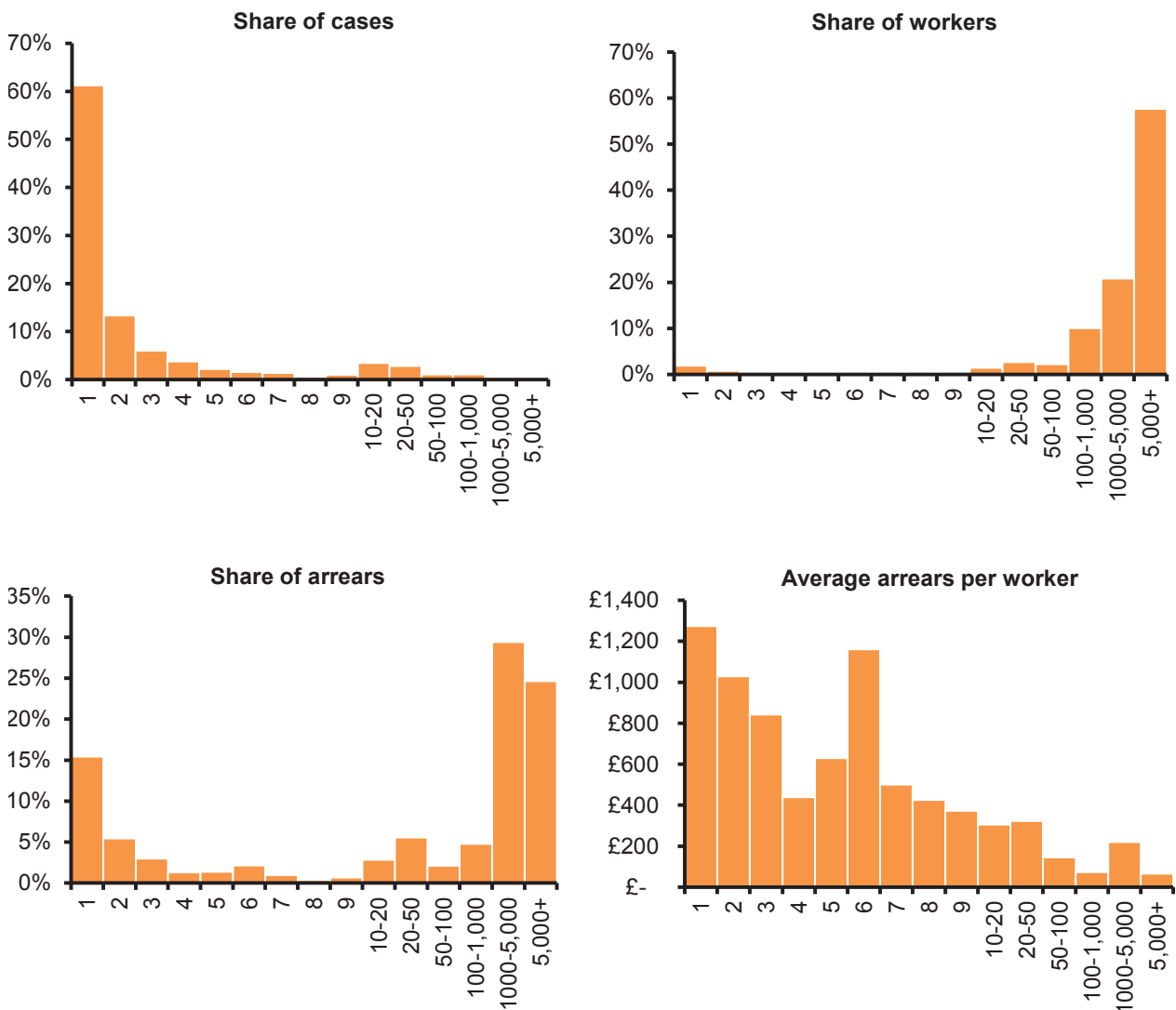
**Low Pay Commission: Non-compliance and enforcement of the National Minimum Wage**

**3.35** Average arrears per worker seem to be declining across naming rounds. Again, this is a result of the larger cases, which tend to involve many more workers but have lower arrears per worker. The Debenhams case again exemplifies this - workers were owed just £11.48 each on average.

**3.36** Figure 14 illustrates the distribution of naming cases by the number of workers involved. The top left panel shows that the vast majority of cases involve just one worker (784 out of 1,280 or 61 per cent). The top right panel shows that these single worker cases account for just 2 per cent of workers in all naming cases. Unsurprisingly, the cases involving more workers account for more, those involving more than 1,000 workers accounted for 79 per cent of workers involved in naming cases – just over 32,000 workers. But there are just 6 cases like these that have been named so far.

**3.37** However, the picture is slightly different where arrears are concerned. The average arrears per head tend to decline with the size of the case (bottom right panel in Figure 14). Cases involving two or fewer workers have on average over £1,000 in arrears per worker, compared to an average that is one tenth of that amount for cases involving 100 or more workers. So even though cases with one worker account for just 2 per cent of workers identified, they account for 15 per cent of the total arrears.

Figure 14: Distribution of naming cases by the number of workers involved in each case



Source: LPC analysis of BEIS published naming cases

**3.38** This analysis of naming cases tells us a great deal about the nature of non-compliance. It shows that HMRC tackles cases that vary significantly from small cases involving just one worker to those involving many thousands of workers and millions of pounds in arrears. It also demonstrates the importance of tackling both kinds of case and all in between. The larger cases affect many thousands of workers but it is the smaller cases, those involving just one worker, where workers seem to lose out the most financially on average.

**3.39** Earlier in this chapter we noted the importance of the larger cases. Just 15 cases for which the arrears were greater than £100,000 in 2016/17 accounted for three quarters of the arrears and over half of the workers identified. Since 2009/10 HMRC has found arrears in 49 cases of this size, but only four have been named so far. For the majority of these cases the underpayments date to before the naming rules were made more flexible or because the case meets one or more of the three criteria for a case not to be named. For others, the complexity of the case may mean that it takes longer to correctly calculate the appropriate penalty over hundreds, or possibly thousands, of workers over several years. Nevertheless, the number of large cases closed so far (49) compared to the number named so far (4) combined with HMRC's extra resource and focus on this type of case suggests that more large employers will be named in the near future.

## Conclusion

**3.40** HMRC's extra tools and resources have led to significant increases in the number of workers and level of arrears identified in cases. In large part their success in 2016/17 has come from targeted enforcement of a small number of large and complex cases, particularly in the retail sector. Self-correction has also been vital to these figures, accounting for a large share of the workers and arrears identified.

**3.41** HMRC operates a policy of targeting certain sectors, this is the appropriate way of working. However, one challenge is that non-compliance can be found in a range of sectors and it appears that there are a number of sectors where enforcement activity has, by comparison, been limited in recent years.

**3.42** The aggregate level of penalties has also increased over recent years, which is to be expected given several policy changes raising the penalty thresholds. But penalties remain well below the total arrears and this is mainly down to self-correction, which does not attract a penalty. Nevertheless the average size of the penalty has increased significantly and HMRC tell us that the largest single penalty was over £1m in 2016/17. The full impact of the shift to a penalty of 200 per cent of the owed arrears introduced in 2016/17 is yet to be felt. In future years we can expect to see the level of penalties rise relative to the level of arrears.

**3.43** Naming has been used increasingly and is helping to raise the profile of enforcement activity and awareness of workers' rights. These cases also help illustrate the need for HMRC to continue to tackle both large and small cases. The larger cases tend to affect many more workers, but workers in smaller cases tend to have lost out more financially.

# 4. The Compliance Challenge: Priority Issues and Groups

## Adult Social Care

**4.22** The Adult social care sector faces a number of compounding issues which have consequences for the sector. Since 2010 the core grant used by local authorities to pay for care has reduced – the House of Commons Library estimate that funding fell in real terms by over 8 per cent between 2010/11 and 2016/17. While the decision in the April 2017 budget to provide an additional £2 billion in funding over the next three years was welcomed by the Communities and Local Government (CLG) select committee, their view is that this is not sufficient to bridge the funding gap.

**4.23** At the same time that the care budget is being squeezed the pressures on it have increased. This is partly a result of rising demand for services caused by an aging population, and partly because of changes to policy such as the 2014 Care Act and the Apprenticeship Levy as well as the National Living Wage. The introductory rate of the NLW is estimated to have cost £600m in 2016/17 by ADASS (Association of Directors of Adult Social Services).

**4.24** The combination of these factors creates a risk of non-compliance in the sector, and yet estimates of the scale of underpayment care vary wildly. In their 2016 report the National Audit Office cited research which estimated that between 160,000 and 200,000 care workers could be underpaid in 2011. By contrast the estimate of underpayment derived from the 2016 ASHE suggests that, at its peak in the year, underpayment affects 18,000 workers (aged 25 and above) or 17 per cent of low paid workers in that sector. Furthermore, in their investigations in the sector HMRC have found a higher than average ‘strike rate’, that is the proportion of investigations where arrears are identified.

**4.25** So the evidence is clear that non-compliance is an issue in social care, but establishing exactly how much of a problem is even more challenging in this sector. Part of the reason for this is the complexity arising from sleep time and travel time. According to the National Minimum Wage regulations travel between work assignments is treated as working time and so must be paid at least the NMW. Similarly, if an individual is at work and required to be there they should, in most cases, be paid at least the NMW, even if they are asleep. Both travel time and sleep time are common features of social care working, and yet the recent CLG select committee report into Adult Social Care noted that: “the common approach across the care sector has been to pay a flat rate for a sleep in shift, rather than an hourly rate, which can result in care workers being paid below the national minimum wage”. The ASHE does not distinguish sleep and travel time and so the estimate of underpayment for these workers is likely to be even more inaccurate.

**4.26** The key impact of any complexity and lack of clarity on hours of work and pay is that workers themselves are less likely to be aware of whether they are paid the correct amount. Indeed, this is a reason for the LPC's recommendation to improve the information provided to workers on their payslips in our Spring 2016 report.

**4.27** Further evidence on this has been provided by UNISON, who carried out a survey of just under 1,000 workers in the care sector at the beginning of 2017. This found that just a third of social care workers could tell from their payslip if they were being paid for all of the hours they are working. It also found that only a third thought they were paid for their travel time.

**4.28** This adds further weight to the recommendation we made in our 2016 Spring Report for greater clarity in the information provided on payslips. We urge the Government to take action on this.

## Worker status

**4.29** Worker status, which is a key determinant of eligibility for the National Minimum Wage, has been in the spotlight recently. Over the last year there have been a number of court cases in which people working in the so-called 'gig economy' have sought to challenge their employment status, arguing that they are workers and therefore entitled to the rights associated with that status, including the national minimum wage. The core of these cases – the grey area around workers status – is nothing new, but what is new the use of technology to enable these forms of work.

**4.30** The increased awareness of the gig economy has refocused attention on some older issues around worker status and its potential ambiguity. The Government commissioned Matthew Taylor to look at these newer forms of employment and assess if the current employment legal framework is still fit for purpose. The Taylor review was published in July of this year and made a range of recommendations on employment status. We at the LPC await the Government's response to the review and welcome any clarity that the outcome can bring to worker status as this is key to enforcing the minimum wage. Individuals need to be assured of their own status, and therefore their rights, in order to challenge their employer or make a complaint via ACAS if they are worried that they are being underpaid.

**4.31** Our stakeholders frequently tell us of concerns relating to worker status. For example, we frequently hear of practices in the entertainment industry which disadvantage people working in those parts of the economy. These include the charging of excessive fees by agents to workers, in many cases people working in these fields are self-employed for tax purposes but may qualify as workers for the purposes of employment law. If this is the case and these deductions take pay below the relevant rate of the NMW then this is likely to be non-compliance and the individual in question can make a complaint to HMRC who will investigate. However, some people, perhaps because they are self-employed for tax purposes, may simply assume that they are not eligible for the minimum wage and so don't challenge the practice. Worker status is also connected to issues around interns, some of whom may be unaware that they are a worker and therefore entitled to the minimum wage. This may, at least in part, explain why there are so few enquiries about minimum wage underpayment from interns (approximately 10 in 2016/17<sup>8</sup>).

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<sup>8</sup> BEIS, 2017. *National minimum wage: government evidence to the Low Pay Commission on compliance and enforcement*, table 3



**4.32** Other stakeholders tell us that employers may be using self-employment to avoid paying the NMW. This is an issue that the LPC looks at frequently and will continue to investigate. The rise in the number of self-employed workers over the last decade is well documented. Self-employment has accounted for 40 per cent of the growth in employment since 2008. And yet, the share of self-employed workers in total employment has shifted only marginally, from 13 to 15 per cent. We monitor self-employment in low paying sectors closely and will look at this in more detail as part of our recommendations on NMW rates later in the year.

## Apprentices

**4.33** In our 2016 Autumn Report we looked in detail at underpayment amongst apprentices using the Apprenticeship Pay Survey (APS) and the ASHE. This found that non-compliance was high relative to non-apprentices.

**4.34** As with underpayment more generally, measuring it amongst apprentices is challenging. Our preferred measure uses the subset of the Apprentice Pay Survey<sup>9</sup> sample who have a payslip stating their hours – thus reducing the chance of rounding errors. Underpayment on this measure rose from 6 per cent of apprentices in the 2014 APS to 15 per cent in the 2016 APS. This is far higher than what we find for other worker types, where between 0 and 2 per cent are underpaid according to the ASHE.

**4.35** This increase in underpayment followed the largest ever increase in the Apprenticeship Rate in 2015, by 57 pence from £2.63 to £3.30, an increase which was greater than that of the NLW in April 2016 compared to its predecessor adult rate the year before. However, unlike the large increase in measured underpayment found for workers aged 25 and above in the ASHE following the introduction of the NLW, it is difficult to put this down to frictional factors. The APS took place in the summer of 2016, several months after the introduction of the £3.30 Apprentice Rate in October 2015, meaning the rate had plenty of time to ‘bed in’.

**4.36** Given the prevalence of underpayment we would expect apprentices to feature heavily in HMRC’s enforcement data, shown in Figure 15. On the face of it these figures show a relatively high proportion of cases involve apprentices; between 10 and 25 per cent of all complaint led cases. And furthermore, these cases have a high strike rate at 75 per cent – the average tends to be between 35 and 45 per cent. While the number of workers and the level of arrears appear low relative to the totals this partly reflects the fact that the data is likely to miscount the number of apprentices involved (see below) and partly reflect the nature of apprentice employment. Apprentices tend to be employed in small numbers; most apprentice employers have fewer than five at any one time. So the chances of identifying a single large employer underpaying hundreds or even thousands – as in the larger cases – are vanishingly small.

**4.37** However, the BEIS/HMRC enforcement data only records where apprentices are involved in complaint led cases, meaning the data will undercount apprentices identified in pro-active enforcement cases. At the same time, the number of workers and the level of arrears in complaint led cases involving apprentices may include other workers identified as part of each investigation but

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<sup>9</sup> The Apprenticeship Pay Survey (APS) explores the working arrangements and earnings that apprentices receive. The survey included almost 10,000 telephone interviews with apprentices enrolled on a course in Great Britain.

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who are not apprentices – meaning the data may over count. Given the evidence on the scale and nature of underpayment amongst apprentices it is important that the BEIS/HMRC information systems are able to accurately establish the degree to which policy is tackling this issue.

**4.38** There is further scope to make progress on apprentice underpayment. Apprenticeship funding is currently undergoing major system-wide change with the introduction of a UK wide apprenticeship levy and a new funding policy in England. This may present an opportunity to tighten up on underpayment. We return to these issues in our recommendations.

**Figure 15: Apprenticeship cases**

	<b>Closed cases</b>	<b>Closed cases with arrears</b>	<b>Strike rate</b>	<b>Arrears</b>	<b>Workers</b>
2015/16	263	196	75%	£558,618	639
2016/17	101	78	77%	£209,851	233

Source: BEIS

### Notes

1. This data includes outcomes from complaint-led investigations only.
2. This data includes arrears for other workers (i.e. not apprentices) identified in the course of investigations of an employer's wider workforce.
3. Apprentices have been made a priority area for targeted enforcement in the 2017/18 SLA.

# 5. Conclusions and Recommendations

**5.1** This report has shown that underpayment, and therefore non-compliance, remains an issue that affects hundreds of thousands of people each year. However, while the numbers of people affected increased following the introduction of the National Living Wage, this is largely due to the increases in coverage – the share of low-paid workers who are underpaid has fallen very slightly according to our best estimates. Furthermore, there have been some real successes in enforcement of the NMW/NLW with the increased use of the tools available proving fruitful in terms of the number of underpaid workers and the level of arrears identified. That being said there are areas that could be improved and in this section we set those out and ask for them to be considered by BEIS and the Director of Labour Market Enforcement when he sets out his strategy in Spring 2018.

## Raising awareness and the number of complaints from workers

**5.2** Good levels of awareness of the rates and how they are applied amongst both workers and employers is a key ingredient in tackling non-compliance. We've shown in this report that there are areas where awareness could be improved. In addition it is clear that underpayment is highest immediately following an uprating, so compliance policy needs to develop a specific approach on this aspect of the problem. The BEIS-led communications campaign carried out in Spring of this year was a good start. **We recommend that BEIS carry out a campaign aimed at raising awareness and the volume of complaints alongside the upratings each year.** This should be informed by an evaluation of the recent campaign for overall effectiveness, to see if it is of sufficient scale and that it is reaching groups whose awareness is low.

**5.3** There may be other routes to reaching workers and raising their awareness. Any support provided when someone enters work, whether it is straight from education or when entering work with support from Jobcentre Plus (JCP), is an opportunity to reinforce messages on eligibility for the national minimum wage and options for redress. More could be done to publicise the rates in JCP. **Government should ensure that it is utilising all potential channels in raising awareness.**

**5.4** The volume of complaints remains low in comparison to the scale of the problem as estimated by our measures of underpayment. Previous qualitative evidence has illustrated the many reasons why workers may not complain and the challenges therein e.g. they are worried about finding a new job or don't know how to complain. Communications activities could focus on this issue, for example campaigns designed purposely to assuage these doubts could be undertaken.

**5.5** The LPC has previously called for a third party protocol to make clear the process. One issue with third party complaints is that there is an unresolvable issue around confidentiality. HMRC are unable to share information about the case with a third party complaint unless that person is acting on behalf of a complainant. This in turn means that HMRC are unable to report progress on the case to the third party, meaning the original complainant remains in the dark. However, there are some options. Firstly, if a complainant formally nominates someone to be their representative then HMRC can share information with that person, but this fact needs to be made clear along with guidance as to how to nominate someone to complain on your behalf. Secondly, HMRC undertaking an assessment at an aggregate level and providing this to third party complainants, particularly unions, may help them understand the impact of their efforts and what they could do more of to lead to more successful cases.

**5.6** Some workers may be concerned about the time it takes to resolve cases, specifically for them to receive their arrears. HMRC has cut the times it takes to investigate cases by 82 days (from 297 calendar days in 2013/14 to 215 in 2016/17). It should publicise this more widely and use its additional resources to cut them further. Also, HMRC told us that in many cases workers are paid their arrears before the conclusion of the case. HMRC and BEIS could look at the time it takes for workers to receive their arrears and publicise this. **We recommend that Government communication efforts include better publicity around the third party complaints process, case studies and/or guidance based around successful complainants and publicising the improvements in the time taken to resolve a case.**

## Raising awareness amongst employers

**5.7** As with workers there is a need to raise awareness amongst employers. Naming is a welcome policy that is likely to both raise awareness of underpayment and discourage it. Our conversations with employers and their representatives suggest that the risk of being named is a real concern for employers and that it is encouraging a focus on compliance. However, we have heard from some stakeholders – both employers and employee representatives – that naming treats all non-compliance the same, both intentional and unintentional, and doesn't provide enough information for employers to learn from.

**5.8** It is important that employers can learn from the mistakes of others so they are not repeated. One way of achieving this is improved guidance, which is a consistent theme of the LPC's work on non-compliance. Over the last few years the Government has improved guidance significantly and HMRC has started to produce sector specific guidance in partnership with trade and other employer representative bodies. However, one area where guidance could be improved is in copying the Pensions Regulator practice of producing "section 89 notices". These notices report the findings of compliance investigations in pensions and turn them into guidance for employers, allowing them to learn from others' mistakes.

**5.9** **We recommend that Government develops a similar approach to the Section 89 notices used by the Pensions Regulator for minimum wage compliance.** This might include guidance following a naming round setting out what the nature of the non-compliance was, focussing particularly on mistakes or technical errors. This could be done at an aggregate or sectoral level (e.g. setting out the causes of non-compliance for the social care employers named in the most recent naming round). Individual employers would not need to be named in this guidance.

## **Action to discourage employers**

**5.10** There is a strong suite of policies aimed at discouraging employers including fines, naming and prosecutions. However, more could be done to maximise the deterrent effect of these policies.

**5.11** The Government's use of naming as part of larger communications effort timed to raise awareness of forthcoming rates changes is to be applauded and repeated. In addition, **we recommend that Government considers undertaking naming rounds on a consistent timed basis e.g. quarterly or 6 monthly, this would create more momentum and press anticipation of each naming round leading to more coverage. It would also allow stakeholders more time to prepare and support.**

Prosecutions are limited, with only thirteen cases successful undertaken since 2007. This is partly due to the expense and complexity and partly because that the civil route offers the better chance that workers will be paid back in full and in good time. Nevertheless, prosecutions that are well publicised could have a powerful deterrent effect. **We recommend that Government looks to increase the number of prosecutions and publicise those that take place.**

**5.12** Previous research commissioned by the LPC shows that many non-compliant employers are unconcerned about the consequences because they believe that their staff will not complain. The low complaint numbers suggest that employers may be right to take this view. Any action that successfully raises the numbers of complaints could in turn be publicised to employers. Other employers are unaware of the increased resources for HMRC, the increased use of naming or the greater number of proactive investigations HMRC are undertaking and so are not worried about being caught. **We recommend that Government takes further action to publicise the increase in enforcement activity as part its communications campaigns.** This might include publicising the number of complaints or the number of cases investigated, doing so by sector and locality may help get the message through.

**5.13** Adding a simple 'tick box' declaration to payroll software whereby the employer is asked to confirm that all of their staff are paid at the correct level could be a helpful 'nudge' to encourage compliance. **We recommend that Government investigates the potential of this change to payroll software.**

## **Recommendations for HMRC's enforcement activity**

**5.14** There are a range of steps that could be taken in relation to HMRC's activity. In particular there is much more we could learn about the nature and extent of non-compliance from the cases that HMRC investigates. For example, we do not know the exact geography of workers identified in cases because in the larger cases workers tend to be 'coded' to the head office of their employer. Estimates of underpayment from the earnings data place a lot of emphasis on occupation, but we don't know the occupation of workers identified in cases and so cannot test if this analysis is accurate or helpful. Furthermore, how much of non-compliance identified in cases is in the 'informal' labour market and therefore is not visible in the datasets we use to estimate the scale of underpayment?

**5.15** Another example might be learning more about the nature of complainants – anecdotal evidence suggests that workers are more likely to complain once they have left an underpaying job, but is this backed up by the evidence in closed cases? Learning more about complainants could help target future communications and enforcement campaigns.

**5.16** **We recommend that HMRC establishes information systems that allow Government to learn as much as possible about the nature and extent of non-compliance from the cases it investigates. These information systems should provide enough information to monitor how well policy is responding to the challenge overall as well as to specific groups and issues.** For example, the current data on apprentices is useful but does not allow a concrete judgement as to whether policy is moving in the right direction.

**5.17** HMRC already undertakes joint work with other parts of Government to gather intelligence and take action on non-compliance. There are opportunities to expand this further and formalise arrangements that are currently ad hoc. Under its risk based approach HMRC could test if information from another source, such as a poor Care Quality Commission inspection within social care, is associated with underpayment. This may require a less risk averse approach and so may in turn need some flexibility in their performance management agreement with BEIS. Other opportunities include identifying underpaying employers through online adverts – ad hoc analysis of job vacancy websites shows there to be high numbers of non-compliant job adverts, even 9 months following the introduction of the NLW. One preventative measure would be for HMRC to establish systems to regularly and systematically search online and send out ‘nudge’ letters automatically. This could include work with DWP’s Universal Jobmatch team to identify non-compliant vacancies. **We recommend that HMRC expands and formalises its work across Government to both gather and share intelligence and take action on non-compliance where this is found to deliver results.**

**5.18** A final area for potential action is on apprentices. The new apprenticeship levy system, also managed by HMRC, will provide intelligence on which employers are paying the levy and, potentially, what frameworks they are studying. This in turn will allow HMRC to identify employers at risk of underpaying apprentices and could use this intelligence as part of their risk based approach to pro-active investigations. **We recommend that HMRC should maximise the intelligence gathered through the new apprenticeship funding system in England to reduce non-compliance amongst apprentices.**

