Low Incomes Tax Reform Group
A voice for the unrepresented

Self-employment and welfare reform

Briefing for peers on Welfare Reform and Work Bill

There are approximately 4.8 million self-employed people in the UK, and rising. Self-employment has been a substantial part of new job creation since the recession.

The self-employed population is very diverse. They include owner-managers of small and micro businesses, entrepreneurs, seasonal traders, workers in construction and IT, farming, freelancers, and so forth. (We do not include the 'falsely self-employed' where the nature of the relationship between them and the engager of their labour is in fact one of employment.)

Whereas the 'national living wage' announced by the Government in the Summer Budget[1] is a welcome development for those who will qualify for it, that does not include the self-employed. Indeed, self-employed workers who employ others may well find themselves paying their employees the national living wage, but unable to draw a comparable amount for themselves from their business.

Tax credits

Many self-employed people with low profits find tax credits a useful way of topping up their incomes without undue bureaucracy, because of the similarities with income tax – the use of the tax year as an assessment period for both, and crucially the fact that profit from self-employment for tax credits is defined in the same way as taxable profits (although loss relief is given slightly differently, the computation of the loss follows similar principles).

However, self-employed tax credit claimants are now subject to a more stringent test if they wish to qualify for working tax credit (WTC). Under new legislation (SI 605/2015), effective from 6 April 2015, a claimant must meet the condition of being either employed or self-employed, as defined. And to be self-employed, their activity needs to be undertaken on a commercial basis with a view to making a profit and it must be 'organised' and 'regular'.

With effect from April 2016, a self-employed claimant must register as self-employed with HMRC for self-assessment and provide their unique taxpayer reference number with their WTC claim.

[1] The national living wage is the national minimum wage (NMW) plus a premium - £7.20 an hour (made up of £6.70 NMW plus premium of 50p) from April 2016, expected to rise to £9.00 an hour by the end of the current Parliament.

It is understood that HMRC select self-employed cases for investigation on the basis of a minimum earnings threshold equivalent to working hours x national minimum wage, and it appears from their guidance that they are using the declared hours of the claimant rather than the hours needed to qualify for WTC.

However, it remains uncertain how HMRC will determine whether an activity is undertaken on a commercial basis, whether there will be differing interpretations of whether someone is employed or self-employed for tax and tax credits purposes, and how claimants and prospective claimants will be helped to ensure they claim on the correct basis to avoid unwittingly incurring an overpayment. HMRC are still developing their guidance.

Universal credit

The regime under universal credit (UC) will be more problematic for the self-employed. The transition is currently scheduled to start in 2016.

The philosophy underpinning the UC treatment of the self-employed is that nobody should benefit from State support to the extent that the profit from their self-employed activity falls below a minimum income floor (or MIF). For most UC claimants, the monthly MIF figure is roughly equivalent to 35 hours a week at the national minimum wage, less a notional amount of tax and national insurance contributions. If actual income from self-employment is below the MIF, the person will be treated as having earnings equal to the MIF for the purposes of calculating their UC entitlement. It applies each month and every month throughout the year. It would be useful to hear from Government ministers whether they intend the MIF to rise to the national living wage when that comes into effect next April.

There are exceptions: the MIF does not apply where the claimant is not subject to full conditionality (eg lone parents responsible for young children, those with limited capability for work, etc) or during a 12 month start-up period.

Those for whom the MIF will be particularly problematic will include:

- seasonal trades
- trades that take more than 12 months to move into profit
- newly established businesses taking on their first employee
- businesses experiencing a downturn, a bad debt, the bankruptcy of a key customer, or other difficult patches
- businesses dependent on the weather and other external factors, such as farming and tourism
- business who incur large expenses in certain months

For example:

- arable farmers who earn all their profit at or around harvest time
- livestock farmers for whom the return they get on their livestock is eroded by the cost of rearing them and getting them to market
- bed-and-breakfast owners in the winter season
- entertainers and others working in unpredictable trades

Besides, our modelling shows us that a self-employed claimant earning the same amount and in the same trade as an employed claimant may nevertheless receive less UC than his/her employed counterpart, because of the influence of the MIF and other complications on the calculation of the award (including the new surplus earnings rules in place from April 2016 in digital areas).

We believe that there are fairer and more efficient ways of achieving what the Government wishes to achieve with the MIF. For example, adopting a system of averaging profits over a period that is appropriate to the business (by default, perhaps, a year) would avoid the burden of having to meet the requirements of the MIF each and every month, given that the natural business cycle of most businesses is over an accounting period of a year, and hardly any business – not even seasonal trades – operate in accounting periods of one month. An annual cycle would reflect more accurately business costs and expenses such as self-assessment tax liabilities, insurance premiums, premises rental, and so forth, which in most cases tend to accrue over a year.

LITRG

17/11/2015