

Self-employment, tax credits and the move to Universal Credit

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Universal Credit is a new benefit for people of working age. It replaces the current range of means-tested benefits for people out of work, the system of tax credits for people in low paid employment, and Housing Benefit for people of working age. It will be implemented across the UK from October 2013.

Some elements of Universal Credit are specific to claimants in self-employment, including a requirement for self-employed claimants who are expected to look for and be available for work: to attend one or more gateway interviews; to provide evidence of self-employment; the use of an assumed income, the Minimum Income Floor, in calculating some awards of Universal Credit; and exemptions from some conditions of entitlement during a start-up period of 12 months from the start of a new claim. There will also be a regime of monthly self-reporting of income and outgoings.

This study set out to learn how current experiences of claiming tax credits might inform continuing development of Universal Credit policy, the extent to which the information requirements placed on claimants are likely to be feasible, and how the distinctive features of Universal Credit (particularly the Minimum Income Floor) might affect people's circumstances and employment decisions.

The findings are based on in-depth interviews with 45 self-employed recipients of tax credits in three areas of the UK in August and September 2012.

Working as self-employed – people's occupations, activities and trajectories of self-employment

Respondents often spoke about their self-employed activity as an important component of the way they lived their lives, cared for their families and sought quality of life. At the same time, people talked about disadvantages and concerns, including low earnings, long hours of work, hard working conditions and financial insecurity.

People in the study had entered self-employment for a range of reasons. As well as people with entrepreneurial ideas, the study included people who find self-employment allows them to fit in caring responsibilities or manage health conditions. It also includes people for whom self-employment provides the most accessible form of employment, such as people in occupations predominantly organised on a self-employed basis, and people who have been unable to secure paid work.

Amongst couples and a small number of the lone parents it was not unusual for people to have more than one self-employed job, or to combine self-employment with employee earnings. People with similar levels of earnings could be at very different stages in their careers. Some people on low earnings were at the start of their career, building up their businesses, whilst others had been in business for a long period of time and were seeing once successful businesses decline.

Patterns of self-employed working, income and outgoings

When asked what their self-employed work involved, people often did not think across all the activities that went towards their work and for some people it was hard to make clear separation of work and non-work activities.

There was a wide range of different working patterns. Some people worked regular hours throughout the year, but some variation in weekly hours was a common experience. It was not always the case that variation in hours reflected patterns in demand and opportunities.

Working hours were often related to the nature of the work, and affected by weather, and demands and opportunities for services and products. Some of the latter were predictable, but others could not be planned for. People who chose lower working hours included some with health conditions and some with family responsibilities.

The relationship between working hours, income and expenditures was not always simple or direct. Some people were paid regularly for work and had few expenses; others were paid a single lump sum following an extended period of work. Overall, some people had income patterns and expenditures which were better understood on an annual basis rather than through monthly flows.

Current experiences of tax credits and financial record-keeping

The experiences of people in claiming and using tax credits were mainly positive. While there were some instances of people having problems, the process of applying and supplying information was generally straightforward for most people in the study group.

A consistent finding was that most people liked the regularity and consistency of tax credit payments based on an annual assessment, which allowed them to feel confident about a stable income they could rely on to pay routine household expenses.

The use of IT was not the dominant mode of record-keeping. There was widespread reliance on simple, paper-based methods of record-keeping, particularly by people engaged in the type of work that does not necessarily rely on the use of IT.

Most people felt 'organised', keeping records and accounts which suited them and their businesses. Others were less organised, perhaps because of being in the early days of trading, with a small minority seeming to have very unsystematic, or almost non-existent, ways of dealing with their self-employed finances.

Few respondents used accountants for year-end accounting and there was no indication that accountants would be thought of as a feasible option for monthly Universal Credit reporting. Overall, the research evidence points to the need for procedures that are geared towards inexperienced self-employed people who lack specialist accounting knowledge or access to professional help.

Meeting the information requirements of Universal Credit

Although they did not welcome additional administrative work most of the people in this study group thought they would be able to meet some or most of the proposed evidence and reporting requirements, at least in the medium term.

The number and types of evidence that people felt they would be able to supply at the gateway interview varied widely according to the nature of their self-employment and the way in which monies came into and out of the business. Some respondents thought they would be able to meet most of the proposed evidence requirements for the gateway interview while others said that only a few were possible.

Reasons given where people said reporting income would be difficult included a limited command of English, a lack of experience using computers, and financial records not being sufficiently well-organised.

Many people said monthly reporting would create additional demands upon their time and some would need to make adjustments to the way they handled their self-employed finances. People with highly variable patterns of income and outgoings saw monthly reporting as potentially very time-consuming.

The seven-day reporting period was generally thought to be feasible, but many respondents identified a range of circumstances when the deadline might be missed and there was concern that claimants might be penalised in such circumstances. There was a widespread suggestion that there should be some flexibility around the seven-day target.

Despite the various concerns expressed by some respondents no-one suggested that they might close down their self-employed business as a result of any new demands on them created by the Universal Credit information requirements.

The Minimum Income Floor

The Minimum Income Floor was difficult for respondents to understand and those who struggled most came to fairly simplistic, negative views. More generally, the Minimum Income Floor caused concern, particularly amongst people on low incomes, with those on higher incomes often understanding that they would not be affected.

Patterns of income and outgoings meant that most of the respondents, regardless of their level of earnings, thought they would be affected by a Minimum Income Floor set at a level equivalent to full-time hours at the national minimum wage at some point. Even those with relatively high earnings across the year thought they might occasionally dip below this level.

Some respondents who were working full time felt a lack of demand and/or an inability to increase prices would prevent them increasing their earnings. People with health conditions and caring responsibilities were concerned where they felt their circumstances prevented an increase in hours or earnings.

Some people thought that if they had a reduction in income because of the Minimum Income Floor they would not change their behaviour, but somehow cope, for example by relying on family support.

Some people thought it might be possible to find ways of raising income above the Minimum Income Floor by working more hours, pursuing other ways of generating income, changing the balance of their portfolio of jobs (do more hours in higher paying activities) or accessing longer hours of childcare.

There was a widespread reluctance to consider abandoning self-employment. However, giving up self-employment, and therefore returning to benefits, or attempting to find paid employment was mentioned as a possible impact of the Minimum Income Floor for a number of respondents.

The start-up period where no Minimum Income Floor is applied for the first year of trading was almost unanimously supported. People's views on its length depended on their business. For businesses with easy access to customers and low start-up costs a year was felt sufficient. For businesses needing to develop a client base, build resources or develop demand for goods it was felt more time would be needed.

Policy and delivery implications

This study has generated new data on how self-employed people organise their business and personal lives which will be of relevance to the ongoing development of policy and delivery of Universal Credit for self-employed claimants.

The research suggests that language in all information products and communications would benefit from echoing the language used by self-employed people as far as possible. The research also identified a need for clarity about seemingly well-understood terms such as 'income' and 'earnings' and consistency in their official use. The initial gateway interview and subsequent interviews for people in the start-up period provide one opportunity to convey information and check understanding.

Because a claimant's Minimum Income Floor will only be set following an assessment by DWP it was difficult to discuss how it would affect individual respondents in detail. This suggests that communications with claimants yet to enter Universal Credit, and those awaiting an assessment of their conditionality threshold, will need to be carefully tailored to reflect this uncertainty.

DWP and Work Programme practitioners will be important sources of information for claimants considering self-employment as a route into employment. Some thought needs to be given therefore about how such practitioners will be able to acquire the necessary knowledge and expertise of Universal Credit that will be needed to inform discussions about self-employment.

There will also be a need for information to be accessible to people whose English language skills will make it difficult for them to engage with the Universal Credit requirements.

Staff conducting initial gateway interviews will need guidance on how people's health and caring responsibilities should be taken into account in determining the appropriate number of hours that will form the basis of each claimant's Minimum Income Floor and conditionality earnings threshold.

There is a risk that the additional quarterly interviews during the start up period are perceived more as a means of surveillance and source of pressure rather than ways in which self-employed Universal Credit claimants can be supported to sustain and develop their businesses. Staff conducting such interviews will need to be trained to have a good understanding of self-employment so that interviews are effective in this supportive role.

Consideration could also be given to how rigidly a seven-day reporting deadline should be imposed and what exemptions might be allowed for reasons such as holidays or sickness, and what allowances might be made in circumstances where a person's capacity to comply is affected by for example language difficulties or cognitive problems.

Some flexibility around the 12-month limit for the start-up period may help reduce the risk that self-employed businesses that take more time to become established and financially self-sufficient may be disadvantaged.

Future evaluations of Universal Credit should ideally include specific components to explore its impact on self-employed claimants.

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The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 909532 20 5. Research Report 829. March 2013).

You can download the full report free from: <http://research.dwp.gov.uk/asd/asd5/rrs-index.asp>

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