

Research report

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

by Roy Sainsbury and Anne Corden

Department for Work and Pensions

Research Report No 829

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

Roy Sainsbury and Anne Corden

A report of research carried out by the Social Policy Research Unit at the University of York on behalf of the Department for Work and Pensions

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# Summary

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 the 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 were 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 to be 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 the 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 the department for Work and Pensions (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.

# 1 Introduction

## Chapter summary

- Universal Credit is a new benefit for people of working age replacing means-tested benefits for people out of work, tax credits, and Housing Benefit. It will be implemented across the UK from October 2013.
- There are a number of specific provisions that can apply to claimants who have some form of self-employment:
  - Attendance at gateway interviews to provide evidence of gainful self-employment.
  - Monthly self-reporting of income and outgoings.
  - The use of an assumed minimum level of income, the Minimum Income Floor, in the calculation of Universal Credit awards.
  - Exemptions from some conditions of entitlement during a start-up period of 12 months from the start of a new claim.
- This study was commissioned to inform the development of Universal Credit policy and procedures. It examined people's current experiences of claiming tax credits and their views on the information requirements of Universal Credit and on how the distinctive features of Universal Credit might affect their circumstances and employment decisions.
- This report presents findings from qualitative research with 45 self-employed recipients of tax credits in three areas of the UK in August and September 2012.

Universal Credit is a new social security 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 after an initial test period in the North West of England commencing in April 2013.

Universal Credit will be available to self-employed people as well as paid employees. For the financial year 2010/11 there were approximately 675,000 tax credit recipients whose main occupation was self-employment (meaning that they derived over half their income from self-employment).<sup>1</sup>

Ahead of implementation the Department for Work and Pensions (DWP) commissioned the Social Policy Research Unit (SPRU) at the University of York to carry out qualitative research into the experiences of self-employed people who are current recipients of tax credits in order to inform the development of Universal Credit policy and procedures.

In this introductory chapter we initially describe the policy background to the introduction of Universal Credit (in Section 1.1) and explain the basic structure of the new benefit and how it will apply to self-employed claimants (Section 1.2). The research questions addressed in this study are set out in Section 1.3 followed by an account of the research design and methods adopted (Section 1.4). The structure of the report is explained in Section 1.5.

<sup>1</sup> House of Commons Hansard, 14 January 2013, Column 572W.

### 1.1 Policy background

#### 1.1.1 From tax credits to Universal Credit

At the time the research was conducted, the legislative basis of Universal Credit had been laid down in the Welfare Reform Act 2012 and draft regulations had been published accompanied by an explanatory memorandum (DWP 2012). Revised regulations were published in December 2012 after data collection and analysis had been completed.

The transition from tax credits to Universal Credit will take place over four years beginning in 2013. Until the introduction of Universal Credit in 2013 people in low paid employment are, and will continue to be, entitled to claim Working Tax Credit and Child Tax Credit in order to supplement their earnings. Working Tax Credit is generally available to people working for 24 hours or more per week (those working more than 16 hours can be eligible under certain circumstances) and is administered by HM Revenue and Customs (HMRC) through the tax system. People working for fewer than 16 hours a week can continue to receive the appropriate out-of-work benefit (such as Income Support or Jobseeker's Allowance), but can only keep earnings up to a disregard level (which varies according to claimant type<sup>2</sup>). Hence people in low paid work are treated very differently according to the hours they work. One set of claimants are part of the benefits system administered by DWP and another set are part of the tax credit system administered by HMRC.

This structure of support for people in low paid work has been recognised as problematic, as summarised in the Government Green Paper *21st Century Welfare* (DWP 2010a):

*'Work incentives for some groups are poor:*

- *Interactions between benefits and Tax Credits make the transition to work risky and uncertain;*
- *The financial incentives to enter work at less than 16 hours are relatively low; and*
- *The rate at which benefits and Tax Credits are withdrawn as earnings increase means that some people see no more than a few pence for every extra £1 earned – resulting in the perception that work does not pay.'*

(DWP, 2010a, p.7)

Universal Credit is designed to address these problems by creating a single benefit, removing the distinction between means-tested benefits and tax credits. It also introduces a new system of disregards<sup>3</sup> and withdrawal rates. These are designed to allow people to keep more of their income in comparison with the current system and to convey the message that doing even a small amount of work is financially worthwhile.

The design of Universal Credit also addresses the problem of overpayments associated with the current administration of tax credits. Tax credits are assessed annually. For all new claimants an estimate of future earnings is used to calculate their tax credit award for the year to follow. At the end of the year a re-calculation is carried out based on real earnings in the previous year. Where

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<sup>2</sup> At the time of writing, single people can earn up to £5 a week before benefit is reduced pound for pound as earnings increase above this figure. For lone parents the disregard level is £20 a week.

<sup>3</sup> The system of disregards has been renamed as 'work allowances' in the revised Universal Credit regulations published in December 2012. We retain the terminology of 'disregards' in this report, however, because this was current usage at the time the research was carried out.

this differs from the estimated earnings a reconciliation takes place that results in the identification of either an overpayment or underpayment. For overpayments the claimant is required to make a repayment (or a series of repayments); for underpayments the claimant receives an additional one off payment. This system of annual assessments and reconciliation has led to large amounts of debt accruing to HMRC, as well as difficulties for claimants required to repay often large amounts of overpayment (National Audit Office 2012; DWP 2010a).

Under Universal Credit earnings will be considered on a month-by-month basis. For most people (i.e. those working as paid employees for an employer) this will be done automatically, with DWP being notified of earnings by a real-time information system being developed by HMRC. Universal Credit should therefore be adjusted quickly and accurately and reduce the possibility of overpayments occurring (DWP 2010b, p.50). For self-employed people, whilst income data will not be available through the real-time information system, monthly self-reporting is intended to ensure that Universal Credit payments accurately reflect claimants' incomings and outgoings.

## 1.2 Key features of Universal Credit

Universal Credit is a means-tested benefit. For those out of work an award (assuming the range of qualifying conditions are met) will be based on a comparison of a claimant's household income and their maximum Universal Credit 'allowance'. In this section we first explain the common components of Universal Credit that will apply to all claims (in Section 1.2.1) and then set out in detail how these have been tailored for self-employed people (in Section 1.2.2).

### 1.2.1 Components of Universal Credit common to all claims

#### *Personal and household allowances*

The Universal Credit 'allowance' is effectively the maximum amount of Universal Credit that can be paid to a household with no other sources of income. A household's allowance will be based on the age and status of its members (that is, single or in a couple) and a range of additional factors, such as children in the household, health and disability of household members, and housing costs.

#### *Treatment of capital*

Capital rules will also apply to Universal Credit in a similar way as the treatment of capital under current means-tested benefits. Capital and savings up to a threshold amount will not affect the amount of an award of Universal Credit, but above that threshold a notional amount of income will be assumed to accrue and will therefore be treated as income. If a claimant has capital above £16,000 then there will be no eligibility for Universal Credit<sup>4</sup>.

#### *Earnings disregards*

An important element of Universal Credit will be the disregarding of an amount of income before the claimant's benefit level will be affected. The disregard will be tailored to a claimant's circumstances with higher disregards for lone parents, couples with children and people with health or disabling conditions. Above the disregard level Universal Credit will be withdrawn at a single ('taper') rate. At the time the research was being carried out, an indicative figure for the taper rate of 65 pence in

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<sup>4</sup> The current lower threshold is £6,000 for Income Support, Housing Benefit, income-related Employment and Support Allowance, and income-based Jobseeker's Allowance. Above this amount the assumed 'tariff income' is £1 per week for every £250. The upper limit above which entitlement to benefit ceases is £16,000.

the pound was mentioned in policy documents (DWP 2010b, p.50), a figure which has since been confirmed in the revised Universal Credit regulations published in December 2012.

### *Conditionality*

In order to receive Universal Credit some claimants will have to fulfil conditionality requirements. These will be different for job seekers and people in work. Job seekers will, depending on their individual circumstances, be required to undertake full job search activities (the All Work Related Requirements Group), some other form of work-related activity or attend work-focused interviews. People in work as employees will be expected to achieve an income equivalent to a conditionality earnings threshold based on an assessment of the numbers of hours they can reasonably be expected to work (taking into account any caring responsibilities and health or disabling conditions) and the value of the relevant national minimum wage. For example, a lone parent with school age children might be expected to work 20 hours a week. The current minimum wage for over-21s is £6.19 an hour. Her conditionality earnings threshold would therefore be 20 x £6.19 or £123.80 a week (£495.20 a month). If a Universal Credit recipient in work (as an employee) does not meet the threshold then they will continue to be subject to the appropriate conditionality requirements. So, for example, they might still be required to look for further work in addition to their current employment.

### **1.2.2 Universal Credit as it applies to self-employed claimants**

The policy aims of Universal Credit for self-employed people set out by DWP are as follows:

*‘We believe Universal Credit should support people to be self-employed but only insofar as self-employment is the best route for them to become financially self-sufficient.’*

(DWP 2012, p.29)

In order to meet these aims, the general approach and principles behind Universal Credit explained in Section 1.2.1 are being modified. They represent a marked shift away from how self-employed people are treated under tax credits. In this section we explain the most significant differences (which also form the core of the research study reported here). They are:

- Meeting a test of ‘gainful self-employment’ in a ‘gateway interview’.
- Monthly self-reporting of income and outgoings.
- The ‘Minimum Income Floor’.
- The ‘start-up period’ for new claimants.

### *The gateway interview*

Claimants of Universal Credit who are in self-employment will be required to attend a ‘gateway interview’ at the start of their claim. The purpose of the interview is to establish that the claimant is in ‘gainful self-employment’. For the purposes of this research the definition of ‘gainful self-employment’ was taken from the explanatory memorandum on the draft regulations and it was this construction that was discussed in the research interviews. Since the fieldwork for the study was completed, the final regulations have been published which refine the definition of gainful self-employment for the purposes of the Minimum Income Floor and the start-up period. The relevant extract from the final regulations is reproduced as Appendix A for reference.<sup>5</sup>

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<sup>5</sup> The full Regulations can be accessed at [http://www.legislation.gov.uk/ukdsi/2013/9780111531938/pdfs/ukdsi\\_9780111531938\\_en.pdf](http://www.legislation.gov.uk/ukdsi/2013/9780111531938/pdfs/ukdsi_9780111531938_en.pdf)

The draft regulations, used in this research project, stated that for a person to be deemed in ‘gainful self-employment’ they would need to show they were ‘in organised, developed self-employment carried out in the expectation of profit, which is:

- Genuine – there is evidence that such work activity is taking place and is done by the individual who presents him/herself for the interview;
- Taking up the majority (that is, at least half) of the claimant’s work week – this would be 18 hours a week for claimants with no limits on their working time, but lower for claimants with caring responsibilities or disabilities, for example;
- Done with the intention of increasing the income received to the level we could expect the claimant to make if working full-time (for their circumstances).’

(DWP 2012, p.28).

In the gateway interview an initial decision will be taken on whether the claimant is gainfully self-employed for the purposes of Universal Credit. The outcome of this decision is relevant for the conditionality requirements they must meet and how their self-employed earnings are treated in the calculation of their award.

As noted above to be considered gainfully self-employed a claimant’s self-employment must be deemed to be their main form of employment. This is likely to be determined by an assessment of their time spent on, and earnings from, their self-employed activity as well as any other employment, in relation to their conditionality threshold.

Claimants also have to demonstrate that they are genuinely self-employed. DWP has set out the types of evidence that might be acceptable to support people’s claims. These include: diaries of appointments, lists of customers and suppliers, proof of tax registration with HMRC, marketing materials to secure new business, a business plan, receipts for stock purchased, order and sales records, and bank statements (DWP 2012, p.28).

### *Monthly reporting of income and outgoings*

As mentioned earlier the opportunities provided by real-time information systems cannot be exploited for most self-employment businesses. For self-employed Universal Credit claimants therefore, a system of self-reported monthly earnings is planned. This is very different from the current tax credit arrangements for annual assessments and reconciliations. Monthly net earnings will be calculated using a simple ‘cash in’ and ‘cash out’ formula, and this figure will be used in the same way as employed claimants’ net earnings figures in the calculation of the next Universal Credit award.

### *The Minimum Income Floor*

The Minimum Income Floor is a policy innovation that will apply to self-employed Universal Credit claimants who are deemed to be gainfully self-employed. The policy aim is ‘to encourage and incentivise individuals to increase their earnings through developing their self-employment’ (DWP 2012, p.30), but also to ‘... limit the amount of Universal Credit a claimant can receive while declaring themselves to be self-employed on low income. This approach will limit the extent to which Universal Credit subsidises underemployment and long-term low-earning businesses’ (p.29).

A claimant’s Minimum Income Floor will be calculated according to their personal and household circumstances and the national minimum wage, in the same way as their conditionality earnings threshold. For the purpose of the research we assumed that for a single person with no restrictions on their working capacity this is likely to be full-time hours (i.e. 35) multiplied by £6.19 an hour (the

current minimum wage rate for an over-21-year-old), that is, around £220 a week or £880 a month. Using the example of the lone parent with school age children, we assumed her Minimum Income Floor would be in the region of 20 x £6.19, that is, around £125 a week or £500 a month.<sup>6</sup>

Claimants subject to the Minimum Income Floor will not be subject to any other conditionality requirements. However, if a claimant's net earnings in a month fall below the level of the Minimum Income Floor then the figure used to calculate their benefit will be the Minimum Income Floor rather than the actual net income. Claimants whose earnings fall below the floor in any month will find that their award of Universal Credit does not fully reflect the difference between earnings and the floor.

### *The start-up period*

In supporting self-employment as a sustainable way of providing an income, Universal Credit policy recognises that self-employment can take time to become established and to show a profit. Hence, a start-up period of 12 months is proposed during which time the Minimum Income Floor rules would not be applied. Instead the actual net earnings figure, regardless of whether this falls below the floor, will be used in Universal Credit calculations.

The gateway interview, Minimum Income Floor and start-up period will only apply to claimants in the All Work Related Requirements Group – that is people who if unemployed would be expected to look for and be available for work. Claimants in other conditionality groups (for example because they are identified as having limited capability for work due to a health condition, or because they are the responsible carer for a child under the age of five) will not need to attend gateway interviews and will not be subject to the Minimum Income Floor, although they will still need to report any income from self-employment on a monthly basis.

The Minimum Income Floor and start-up period will also not apply to people who are undertaking self-employed work, but as a result of the gateway interview are not deemed to be gainfully self-employed. In these cases the claimant will be **expected to look for and be available for work**, although their self-employed activity may be reflected in their work-search requirement where an adviser considers it an appropriate job goal. These claimants will need to report their self-employed income on a monthly basis.

As can be seen in this section Universal Credit will apply to self-employed people in a number of important different ways compared with claimants in jobs working as an employee. There are differences in the substance of the regulations (such as the Minimum Income Floor) and in the claiming procedures (such as online monthly reporting). There are a range of research questions raised therefore, which are set out in the next section.

## 1.3 Research questions

The overall aim of the research agreed with DWP was as follows:

*'... (to) examine the ability of self-employed claimants to evidence their level of earnings and the genuineness of their self-employment, with the aim of informing the development of the gateway process and the approach to monthly reporting of earnings ... (and to) investigate how respondents believe they will react to the policy, including how it will affect their behaviour and circumstances.'*

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<sup>6</sup> These figures are for illustration only and will have changed by the time Universal Credit is introduced for self-employed people in 2014.

Within this overall aim the research study addressed the following specific issues:

- How variations in working patterns, income patterns and record-keeping, may interact with Universal Credit.
- How claimants interact with the tax credits system, including what works well and what works less well.
- Capabilities of self-employed claimants and how these may interact with requirements under Universal Credit.
- Causes of, and ways to reduce, misreporting of information, including respondents' potential use of an online tool for recording income and outgoings.
- Attitudes towards Universal Credit (including the Minimum Income Floor, start-up period, the gateway check, monthly reporting) and the likely impact on behaviour and circumstances.

A topic guide was designed to explore these issues. It can be found as Appendix B.

## 1.4 Research design and methods

The nature and the sensitivity of the data required from respondents indicated that individual, face-to-face interviews would be the most appropriate method of data collection. Forty-five interviews were carried out with self-employed tax credit recipients from three geographical areas: London, East Sussex and Newcastle using the topic guide agreed with DWP.

This was a qualitative study aimed at increasing our understanding of self-employment and tax credits and the implications for Universal Credit. It was therefore never the intention to generate an achieved sample that was **statistically representative** of the population of self-employed tax credit recipients. The aim was to create a purposive sample that ensured that we included in the research people who displayed a range of characteristics identified as possibly having some bearing on their experience of self-employment and tax credits.

We aimed therefore to cover a range of key characteristics in the achieved study group, including men and women, level of self-employed income, hours worked per week and length of time in self-employment. We also wanted to include a balance of people in different age groups, household types, different occupations, and where possible cover a range of different types of self-employment (such as sole traders, people in business partnerships and franchise holders) and to include some people who employed accountants in dealing with their business finances. Given the impact of Universal Credit on people on lower incomes, people in households earning below £11,000 a year were deliberately oversampled.

The respondents were selected from a sample supplied by HMRC through the auspices of DWP. The sample contained data on income levels, hours worked and length of self-employment. These were grouped into the following categories for the purposes of selection:

**Table 1.1** Categorisation of key sampling variables

Sampling variable	Definition of category
Income level	Higher: over £11,000
	Medium: £5,000 – £11,000
	Lower: below £5,000
Hours worked each week	Up to 16
	16 – 17½
	Over 17½
Length of self-employment	Recent, within the previous two years
	Longer term, over two years

Data on the other sample characteristics were not available in advance but were monitored as the achieved study group was building up. Table 1.2 presents data on the main characteristics of people in the study group.

**Table 1.2** Main characteristics of achieved sample (n=45)

Sex	Male	14
	Female	31
Age	Under 30	4
	31 – 50	30
	51 –65	10
	65+	1
Household	Single	7
	Lone parent	14
	Couple, no children	4
	Couple, with children	20
Income group	Higher	14
	Medium	16
	Lower	15
Hours worked each week	Less than 16	12
	16–17½	12
	Over 17½	21
Length of self-employment	Under two years	22
	Two years or more	23
Type of self-employment	Sole trader	42
	Partnership	2
	Franchise	1
Use of an accountant	Yes	10
	No	32
	Not known	3

A wide diversity of self-employed occupations was also achieved, as discussed in detail in Chapter 2.

As can be seen from Table 1.2 the sizes of the sub-groups within the **income group** and the **length of self-employment** were roughly equal. This was the intention. Within the **hours worked** category the aim was for roughly half the sample to be working in the ‘over 17½ hours’ category with the rest of the sample split between the two other groups. Again this was largely successful.

Whilst we were not trying to achieve any particular targets for the categories of **age** and **household** the achieved sample mirrored closely the proportions within the self-employment tax credit population (using figures produced specifically for this research study by HMRC). This was not the case however for sex. The achieved sample comprised two-thirds women and one-third men while the self-employed tax credit population contains one-third women and two-thirds men. It is likely that this outcome is the result of a number of factors, including the decision to over sample people in the lower income groups (where women who work part time are disproportionately represented).

Reflecting on the composition of the sample we are confident that we have sufficient numbers within the categories identified as of particular relevance (type of self-employment, income, hours worked and length of self-employment) to be able to allow us to identify whether these characteristics influence experiences or decisions about self-employment. Also, because the distribution within the other categories (age and household) reflected the tax credit population we are confident that we have not introduced any sample bias from these sources that could affect interpretation of the findings. Further, because we do not attempt to make any generalisations from any of our findings to the whole population of tax credit recipients, the imbalance in the achieved sample between men and women has no implications for the interpretation of findings.

## 1.5 Structure of report

Chapter 2 presents findings on self-employed activities and experience of self-employment among the study group members, including descriptive data on their occupations, the range of business arrangements adopted, how self-employment is combined with other work, and how people came to be in self-employment. The chapter also discusses some trajectories of self-employment, and how this way of working fits people's lives.

Chapter 3 continues the analysis of the self-employment experiences of people in the study group. Different kinds of work and varying patterns of activity may, in turn, lead to different patterns of income and expenditure. We present data on patterns of working across the year, ways in which money came in as a result of self-employed work, and how expenses are incurred in the course of working.

In Chapter 4 we identify what lessons can be learned for the implementation of Universal Credit from people's current experiences of claiming tax credits and financial record keeping. Data is presented on how information is supplied to HMRC for the purposes of claiming tax credits, how financial records of self-employment are kept, and how people use their tax credit awards. People's responses to a proposed online record-keeping tool being developed by DWP are also discussed.

In Chapter 5 we examine how the sample of self-employed tax credit recipients reacted to the proposed information requirements for claiming Universal Credit, including for the gateway interview and for monthly reporting. The chapter also sets out people's views on how their behaviour might be affected by these requirements.

Chapter 6 explores how people in the study group understood the principles of the Minimum Income Floor, how they thought it might affect them, and how they might respond as a result. The chapter concludes with an analysis of the study group's views on the proposed start-up period.

Chapter 7 discusses what lessons there are from the main findings for the development of Universal Credit policy and delivery in the future.

## 2 Working as self-employed – people’s occupations, activities and trajectories of self-employment

### Chapter summary

- People enter 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.
- The sorts of work people did varied considerably. The study included people in a range of occupations, including service industries, retail, construction and manufacturing.
- 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.
- Whilst most people were sole traders, there were two business partners. Also, some of the sole traders were working on an agency basis, with little control over their hours, and consequently little or no ability to increase their earnings.
- People with similar levels of earnings could be at very different stages in their careers. For example, 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.
- 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.
- In order for self-employed people to receive appropriate treatment in Universal Credit the application procedure, gateway interviews, and conditionality will need to be able to deal with the complex ways self-employed people organise their work.

The descriptive material in this chapter provides some understanding of the range of activity and experience that will exist amongst self-employed applicants for Universal Credit, and explains why people work in this way. Understanding the reasons why people enter and maintain self-employment will help support consideration of how policy interventions may be experienced and how claimants will respond. Similarly, the operational delivery of Universal Credit will need to be based on an understanding of the ways in which self-employed people organise their work.

Section 2.1 describes the range of occupations of people in the study group, and Section 2.2 describes the range of business arrangements. Section 2.3 describes ways of combining self-employment with a second job, and Section 2.4 reports what people said about their routes to self-employment. Section 2.5 discusses some trajectories of self-employment and how this way of working fits people’s lives. Section 2.6 presents a number of case examples from the study group that illustrate some of the complexity in the working lives of self-employed people.

## 2.1 Range of occupations

People in this study group were engaged in a range of self-employed activities. Among the main occupations of people in the sample there was strong representation of service occupations, including hairdressing and nail care, child-minding, pet care, house and premises cleaning, gardening and handyman services and property management. Administrative services included research and book keeping. People engaged in retail included those who ran small shops of various kinds and people selling online. Construction industries were represented by people working in traditional trades on building sites, and people engaged in renovation and refitting. Health-related services included dental care, weight control, rehabilitation and complementary therapies.

People working and teaching in arts and entertainment included musicians, painters, writers and vocalists. Others involved in education taught literacy and numeracy, in home environments. A group of men worked in taxi businesses, as drivers and controllers. Small-scale manufacturing was represented by women who had developed their skills in working with fabric, paper and card into making items for sale, through craft fairs, galleries, media advertising and online.

**Table 2.1 Main self-employed occupation of respondents**

<b>Occupation type</b>	<b>Number</b>
Miscellaneous services <sup>1</sup>	10
Retail	6
Health and related services	6
Cleaning	4
Construction	4
Arts, entertainment	4
Transport	3
Education	2
Administration	2
Manufacturing	2
Finance	1
Food services	1

<sup>1</sup> Miscellaneous services include, for example, hairdressing, nail care, pet care services.

We did not ask systematically about people’s qualifications and skills, but we did collect some information here. The group included people with a range of trade and vocational qualifications, for example in construction trades or hairdressing. Some people had training and professional qualifications related to teaching, childcare, accountancy, health services and driving instruction, and some had backgrounds in administration, computing, finance and management. A small group of people in older age groups had previously run successful businesses, with premises and employees, but were now working on a smaller scale. The group also included people enrolled at universities who had self-employed activities at weekends and in evenings.

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Several people were currently engaged in extending their qualifications, or maintaining and building up skills, as described in Section 3.1.1.

### 2.2 Range of business arrangements

Self-employment covers a broad range of business organisation types, including sole trading, business partnerships, franchise or agency working, and sub-contracting. These different business arrangements involve different levels of control of activities, different shares of business profits and varying capacity for extending business. It will be important that Universal Credit takes into account such diversity of business organisation.

#### 2.2.1 Sole traders

The study group included examples of all the main forms of organisation of self-employed work. Most people in this study group were **sole traders**, in relatively modest undertakings. For some this meant having control over the amount of work taken on or the hours worked, for example managing regular appointments with a list of customers so that work could be fitted into school hours. However, some of the sole traders did not have such autonomy. Some had to respond to opportunities as they arose in order to maintain business viability. In this study group, for example, people responding to job offers through ‘Yellow Page’ enquiries sometimes found it hard to control work flow. This is discussed further in the next chapter.

#### 2.2.2 Business partnerships

In business partnerships, partners share profits, losses, assets and liabilities. There is an assumption of equal shares, unless there is a formal or informal agreement otherwise. In most business partnerships there is the possibility of allocating income to a partner in ways that are advantageous (for example, for tax). There were two business partnerships in the study group; in both cases, domestic partners worked together in small retail and catering outlets. We do not know what the formal profit allocation was, but it seems likely that in both cases partners had equal shares. Another arrangement found among some couples who work together is for one domestic partner to be self-employed, and the other to be an employee of the business, although there were no such examples in this study group. It will be important that Universal Credit arrangements take account of these different forms of partnership working.

Another point, of relevance to Universal Credit policy, is that in both formal business partnerships and households in which domestic partners work together it is often the case that one person takes the main responsibility for the book keeping and accounts. It is possible that the claimant is not the person who keeps accounts and hence the task of supplying information on a monthly basis under Universal Credit will not be as straightforward as under tax credits.

#### 2.2.3 Business franchises

Both sole traders and business partners may be engaged in a **business franchise**, an increasingly common arrangement in some retail and service industries. Typically, a controlling company makes available assets required for business start-up, such as stock, customer lists, marketing materials, premises and equipment. Depending on arrangements, the start-up may require a substantial financial investment. The franchise holder then trades as self-employed for a percentage of profits, or commission on similar measures of output, such as number of contracts established with customers, or club memberships achieved.

In a business franchise the controlling company usually maintains close involvement, for example in controlling the geographical area in which trading is allowed, and the range of products or service components being offered. This may set some limits to business development for the trader. It is known that decisions about sustaining a franchise are influenced, for some people, by wanting to recoup the initial investment or by the financial penalties of moving out. It will be important that Universal Credit staff conducting interviews with self-employed people understand such aspects of franchise holding. The franchise holders in this study group were women with, respectively, a high street retail outlet and a health-related promotional activity. A third person had a second form of self-employed retail activity which appeared to be a small food outlet franchise.

#### **2.2.4 Sub-contracting and agency work**

Also in the study group were some people who, although treated as self-employed for tax and National Insurance purposes and for tax credit purposes, worked in circumstances which seemed closer to those of an employee. **Sub-contracting** is particularly widespread in the construction industry where people supply labour for a fixed wage with a contract to the main contractor or the contractor’s administrative agent, and no other entitlement to profits from their work. For this group of people there is usually risk of having periods with low income or none at all. The study group included men working in this way in construction trades, and there is further discussion of the impact on earnings in Chapter 3.

Some kinds of employment are also increasingly made available as ‘**agency work**’. Formal arrangements vary here – some people are technically employees of the agency, but others find an opportunity for a specific job through an agency, after which they become technically self-employed. In this study, at least one person worked in this way, with a few hours regular work for a low hourly ‘wage’. Our understanding is that under Universal Credit some people working in agency or sub-contracting arrangements will not be subject to the Minimum Income Floor because they will not satisfy the test of being ‘gainfully self-employed’. Decisions about gainful self-employment will be made on the basis of information collected during gateway interviews. Staff conducting these interviews will therefore need to be trained and knowledgeable about these different forms of employment and how to make judgments about what satisfies the criteria of gainful self-employment.

### **2.3 Combining self-employment and other work**

When people have more than one form of self-employment or combine self-employment with working as an employee, there are important issues for Universal Credit. Reporting arrangements must enable people to provide appropriate information about different income streams. Judgements about whether a person is gainfully self-employed may not be straightforward, for example if a person works long hours at two or three different self-employed activities which each generate low incomes.

Universal Credit will be based on household income, and both partners may be subject to conditionality. Possibilities of multiple income sources from self-employment and waged work are increased among claims from couples. This study shows how some people combine self-employment with other work, and the different kinds of work undertaken by domestic partners.

In this study group, self-employed earnings from one activity were the only source of earned income for all of the single people in the study group and nearly all the lone parents. However, among people who lived with domestic partners it was not unusual to have a second job. Over half of the self-employed respondents in this study lived with a domestic partner and most partners also had some kind of paid work.

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Among people who lived with a partner but had no children, only one described being the sole earner. Others said that both they and their partner worked, but their partner’s earnings were higher than their own

People who lived with a partner and children presented a mixed picture. Among the sole earners were men with large families, whose partners were mainly occupied with childcare, and people whose partners did not do paid work for other reasons. Some said their partner had earnings (from either self-employment or working as an employee) that were higher than their own. Included here were some women with small-scale enterprises currently fitting around family responsibilities and people whose partners had a higher earnings capacity because of their long careers, specialist skills or qualifications. Some parents thought of themselves as joint earners (such as people in business partnerships).

Second kinds of self-employment were sometimes quite different from the main work, for example offering teaching in time available when not involved in an administrative activity. One person had four different kinds of self-employed work, each drawing on a different artistic skill. All the second jobs undertaken as employees, for example as a cleaner, teaching assistant or personal assistant, were in areas of work quite different from people’s main self-employment. These second streams of income from a job as an employee were often described as important sources of regular and reliable earnings. Even when employee earnings were low, for example a few hours regular cleaning work, these provided a small, but secure, financial contribution to household income, and some basis for budgeting when self-employed earnings fluctuated. Some people hoped to build up their employee earnings in the future, for income security and higher living standards, at the same time enabling them to maintain their self-employed activities, especially when these were in artistic or creative areas.

Looking now at the partners of self-employed people in the study group, those few who did not themselves have earnings included people over State Pension age or waiting for a work permit, partners with health conditions who required care, and women with three or more children at home. Apart from the couples who were in business together, other self-employed partners were engaged in a similar range of occupations as already described for the respondents – services, arts, small scale manufacturing, professional consultancies – as well as farm work. Partners who were employees worked in shops, children’s centres, and administration.

We shall see in Sections 2.4 and 2.5 that a partner’s occupation and capacity for work was often important in decisions made by the couple about self-employment, and fitting paid work alongside family care.

### 2.4 Routes to self-employment

The length of time in people’s current self-employment ranged from 30 years to three months. We have considerable data on reasons for entering current self-employment, and some data on reasons for remaining self-employed. Overall, influences on routes to self-employment fell into the following main groups:

- Doing work traditionally organised around self-employment.
- Perceiving few options as an employee.
- Wanting to build on an idea, or aspiration.
- Needing to accommodate family needs.
- Combining self-employed work with study.
- Finding ways to work while managing ill-health.

### **2.4.1 Work traditionally organised around self-employment**

A wide range of occupations and ways of working are traditionally done as self-employed. People in the study group who set out on a career in professions such as accountancy, finance and some health services knew that, as careers progressed, they were likely to work as self-employed. People who chose technical and vocational careers in creative arts, construction industries, and child-minding knew that much of this kind of work was organised around self-employment. ‘Having your own business’ by running a small shop or family-owned restaurant meant being self-employed. Some respondents in older age groups and people who had maintained current self-employed work for five or more years described this kind of experience.

### **2.4.2 Limited opportunities for paid, employee work**

Some respondents said they saw few options in the labour market as an employee but were committed to working and had taken opportunities available as self-employed work. Included here were older people made redundant from jobs as employees, people who had limited English language and work-related skills, and people with work permits which imposed restrictions. Men who had taken this route were doing work on construction sites, and taxi driving; women described doing cleaning work.

### **2.4.3 Building on ideas and aspirations (the entrepreneurial model)**

Some people in our study group might be said to fit the traditional ‘entrepreneur’ model – deciding to build on an idea or aspiration and work up activities to generate income. Redundancy in middle age had triggered one such person into action. ‘Going mobile’ from a home base was one way of continuing to do the same work when a high street business closed. Some people had retrained to gain qualifications necessary to put their ideas into action. Others described moving from out-of-work benefits to try to build up an interest or skill which might be a route to generating earned income. These were mainly women, who already made things or offered services on a friendship basis or for small payments, or knew of a particular need for a product or skill, sometimes through their own personal experience, and thought they could offer this.

Amongst this group were people who described having help and advice about business start-up in the past from DWP and Jobcentre staff, such as Disability Employment Advisers, New Deal for Lone Parent Advisers or New Deal 25+ advisers, all of whom had found this very helpful. They had variously received Enterprise Allowance, New Enterprise Allowance, Return to Work Credit, one-off start-up grants and travel vouchers, and said how much these had helped. One such business was still running successfully after three years but a more recent entrant said it was surprising that advice and information from DWP about becoming self-employed was only offered after a transfer from Jobseeker’s Allowance to Employment and Support Allowance. The group also included one person on the Work Programme.

Other people who had acted on what seemed a good idea or a new opportunity included people who had left a paid job to join a family business, and then branched out on their own.

### **2.4.4 Accommodating family needs**

A need to accommodate family needs was a strong influence in paving the way to self-employed work and, for many such people, was of key importance in staying in or building their work. This was true for both some lone parents and some couples. Lone parents with young children had seen opportunities for working flexibly from a home base, thus working around children’s needs and reducing need for childcare. Reducing need for childcare was not only a financial consideration – women wanted the best environment for their children’s development and for some this meant

looking after their children themselves. Women who had taken this route had sometimes built up fairly successful businesses, which they were hoping to sustain, and develop further when children were older or had left home. The group of lone parents included grandmothers in their 50s who were formally sole carers of a grandchild, sometimes having left a paid job in order to take this on.

Both men and women in two-parent families also described being able to take their share of family responsibilities by working as self-employed. There were some large families in this group, with three to six children, and some couples managed their family life by one or both parents being self-employed with some flexibility in their work. It was not unusual in such situations for parents to juggle different forms of self-employment and work as employees between them.

When there was a child with chronic illness or special needs in the family, both lone parents and people with partners said they were influenced in being self-employed by wanting to fit work around their care for the child. People whose partner was disabled said this meant they sometimes had an extra share of responsibilities for their children. A third grandmother had seen self-employment as a way of working that enabled her daily caring responsibilities for a grandchild who lived locally. Needing employment with accommodation attached influenced one couple’s decision to take over a retail business.

### 2.4.5 Combining self-employment with study

People who were combining self-employed work with study had found opportunities for weekend work which enabled them to continue with their course work. Their long-term goal was completing a degree, to take forward a professional career in an area of work quite different from their current self-employed activity. One such person had found that working with a friend, in home maintenance work, enabled them to take on larger projects together and make more money. Another person, with children, had been able to build up a short customer list in the university town. Once they had finished their studies these people expected to work mainly in their chosen careers. However, the group did also include another older man who said his small-scale self-employed work as a student, some 30 years ago, had built up into a business he had sustained ever since.

### 2.4.6 Managing poor health

Poor health was a driver into self-employment for several people in the group. Both men and women described having been unable to maintain full-time work as an employee as long-term conditions deteriorated, or following an episode of mental illness. They had found they could manage to sustain some element of their previous activity by working fewer hours from a home base, for example offering teaching. Another example was a person who had a serious accident, with life changing impact that meant having to look for a completely different kind of work.

Usually, overall household income for people with a health condition was increased by a partner’s earnings, and in some cases the partner’s own self-employed activity enabled them to give care and support to the respondent when required. People with poor health described some fairly lengthy periods of sustaining self-employment, most for several years. Nobody in the group said their own route to self-employment had been influenced by the need to care for an adult partner, but some said that being self-employed had enabled them to take on a family caring role when the need arose. This was the situation described by one person currently fitting her full-time work around caring for an elderly relative with terminal illness.

This section has described routes to self-employment described by people in this study group, and reasons for sustaining their activities. It is important to understand that the routes were not mutually exclusive. There were several examples of families where the need to accommodate family needs had come together with having an idea, with the end result of being self-employed. Others

talked about having had a long-term aspiration or idea about running their own business – ‘my dream’ – and deciding to go ahead when they perceived limited other options, for example when made redundant from work in an area of high unemployment. Some lone parents said what was most important to them, in moving from benefits to work, was finding a way of working that fitted family life – working as self-employed seemed a way of doing this.

It is important to remember here that there were several people in the study group who probably would not have been claiming out-of-work benefits if they had not currently been working, for example because they had working partners, because they were over state retirement age, or had restricted residence rights.

## 2.5 How self-employment fits people’s lives: trajectories of self-employment

Understanding low income self-employment requires some understanding of trajectories of life histories and employment. In ways similar to changes in household formation and dissolution, and career paths in work as employees, there can be dynamic processes in people’s self-employment. Interestingly people with similar earnings and hours could be at very different points in their self-employment, which present different challenges for policy makers. For example, people with low incomes could have just started a business and be waiting for it to start generating profit, or be in a long-standing business that was in decline.

### 2.5.1 Beginning self-employment

As we might expect in a low income group, some people were right at the beginning of a self-employed venture, just three to six months in when interviewed. They were generally forward looking, hopeful of sustaining and building up activities, and possibly increasing earnings, for example as their customer base grew, or as family responsibilities lessened. There is recognition in Universal Credit of some of the uncertainties and challenges of business start-up. It will be important that people thinking about moving into self-employment receive high-quality advice and support from Work Programme or DWP advisers who will need to have full understanding of what is needed to satisfy the test of gainful self-employment under Universal Credit.

### 2.5.2 Business on the decline

In contrast to people just setting out on self-employment were those in the group who acknowledged that their current activity was on a downwards trajectory. Two business partnerships were on the market, no longer financially viable for the respondents or proving unmanageable because of the long hours of work. One older person described currently trading at a loss, possibly because his work depended on the economic climate in financial and commercial trading. Another man feared that his work might come to an end soon, because the company for whom he worked was not doing well. When they looked to the future, such people were not expecting business growth. Those of working age were thinking about the possibilities of working as employees; older people were thinking towards retirement. A small group of people with deteriorating health said they would probably soon be at a stage where they were unable to work at all.

We were also told that it is not always easy to leave self-employment: some businesses are hard to sell, and family disruption can be great. Business debts which can be managed or negotiated when secured on business assets or categorised as ‘expenses’ would follow a person leaving self-employment, and some perceived that situation would be very difficult. In Section 2.2 we explained some of the financial incentives to keep a franchise despite low profitability. It will be important that

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Universal Credit staff understand such issues when discussing with claimants the possibilities of ending self-employment.

### **2.5.3 Stable long-term self-employment**

At other points along this spectrum were people who had been managing four to ten years of their current self-employment, in ways that suited their other responsibilities and personal circumstances, and some who had worked for more than 20 years in occupations traditionally done as self-employed. Their focus for the time being was on sustaining family life and job satisfaction

### **2.5.4 Previous experiences of self-employment**

We should also mention people in the group who had previous histories of self-employment, prior to their current activity. (The length and number of ‘start-up periods’ allowed for Universal Credit applicants is discussed in Chapters 6 and 7.) The study group included some people who had run previous successful businesses themselves, generating good income, and some had previously worked within successful companies, with higher earnings. Experience of previous success had led to some ‘new starts’. For example, experience of joining a well-run financially viable business had been influential in encouraging some people to try things, branch out or start-up on their own. We have already described how ‘going mobile’ as a sole trader developed through closure of a successful business partnership.

There were also some examples in this group of people who had experience of failure of previous business ventures and even bankruptcy. When the reason for a previous business failure or closure was beyond a person’s control, this had not put people off trying again, sometimes within a different business organisation. One example was a person whose previous large and profitable business was ended by the collapse of a major finance company, but who decided to go on trading on his own, using lifetime skills and experience. Other people whose previous self-employed ventures had failed decided to try again, influenced by the need to accommodate family life, or because they saw few other options.

## **2.6 Case examples of diversity of self-employment**

In this chapter we have presented, in separate sections, an analysis of the diversity in people’s working lives, how they combine self-employment with family responsibilities, the hours they work and their routes into self-employment. In this section we present two case examples of people in the study group to show how this diversity is manifested in individual lives. Such examples can be useful in thinking about how Universal Credit will fit in people’s lives, whether it is likely to have the desired outcomes and how the proposed administrative arrangements might work.

The first example is a woman who combined self-employment and waged employment, fitted work around caring for children, worked highly variable hours and did not always have clear boundaries between work and ‘non-work’.

**Case example 1 – The creative worker**

Ms A was a single parent with a school-age child and worked as a sole trader. She had training and skills in two streams of artistic work, and her long-term goal was for this kind of work to be her main employment. For the time being, bringing up her child was of high priority, and she had found ways of combining family life, maintaining an income and continuing to build her skills and artistic reputation.

Arrangements were complex, however. She had two different small jobs as an employee on four days a week during school hours, and fitted her artistic work into time left over and around her child’s needs. Some evenings she could fit in three to four hours work, but this did not always work out. She tried to work at least one full day each week in the home workroom – the day on which she did not work as an employee. Her work pattern was further adjusted during school holidays, in order to spend more time with her child. She knew her hours of work, overall, easily met requirements for her tax credit claim, but they were usually different each week, and she found it hard to put a figure on them.

She had recently taken on an additional stream of artistic work, which increased her range of skills and techniques for the future. Small amounts of this work were available occasionally – for example, making an artistic item that would take two to three hours overall. This work did not have to be done in the workroom or done in ‘work time’, but could be done while watching television with her child, or keeping an eye on the computer games.

Numerous other components of work had to be managed, and took up time including marketing and advertising her skills and items for sale, networking, travelling to sales events and galleries, buying materials and negotiating commissions.

The second case example is of a man who had been in sustained low income self-employment, despite working long hours every week. He was experiencing declining income but was unable to control his workload or prices. His options for waged employment were perceived as low.

**Case example 2 – The taxi driver**

Mr B, a sole trader, was the only bread-winner for a large family. He was in his mid-40s, and said his health was good. He had supported his family through a series of low-paid jobs in the catering industry, but had several experiences of being laid off when business was slack, so decided to try taxi-driving. He saw few other options, having no qualifications and speaking English as a foreign language.

He had sustained this work for five years. He worked regular, long hours through evenings and nights and usually spent 40 hours or more at work every week. He used his own vehicle, but was controlled by a taxi firm which notified him of journeys and set fares. In the first two years of this work he was making a reasonable living. But his profits had been decreasing and he was getting fewer and fewer fares. It was not unusual now to wait two hours for a fare, which turned out to be a short local journey paying only a few pounds.

Mr B could not increase his hours of work – he wanted to take some share in family life with his children, and was already working long hours. (Health and safety considerations put restrictions on the length of driving time licensed taxi firms allow their drivers.) Mr B could not increase the number of fares he took or the fares he charged, as both were under the control of the taxi firm.

### 2.7 Discussion

The heterogeneity described in this chapter, in types of occupation, forms of business organisation, influences on being self-employed and the way in which self-employment fitted people’s various personal and family circumstances sets the context for what follows in later chapters which explore how self-employment will be dealt with in Universal Credit. It also reveals some of the complexity that Universal Credit will have to accommodate in regulations and in administrative arrangements.

The main forms of self-employment are sole trading, business partnerships, franchise-holding, sub-contracting and agency working. These different kinds of business organisation are reflected in different levels of autonomy and control, different ways of sharing business profits, and different possibilities for business growth, all of which will be important factors in judgments about whether claimants are in ‘gainful self-employment’. Such judgments are likely to be most challenging where people work under agency or sub-contracting arrangements.

The study showed that it was not unusual for a self-employed person to have a second job, either as self-employed or as an employee. Partners of self-employed people also had one or more jobs (sometimes including self-employment). It may be challenging for policy makers to devise simple rules and procedures to fit all households in which one or both partners have some form of self-employment.

Findings about people’s routes to self-employment and reasons for sustaining this way of working show how important self-employment can be in supporting other arms of government policy – strengthening families and support for children, and enabling some people with severe health conditions to participate in employment.

There is already some recognition of trajectories of self-employment in the Universal Credit arrangements for people in the first year of business start-up. It will be important that people who move into self-employment (including through the Work Programme) receive high-quality advice and support. This should include discussions about how to ensure that any planned self-employed activity satisfies the ‘gainful self-employment’ test.

The intention is that some people judged to be continuing self-employed activity with little chance of increasing income may be advised to seek other options. Our findings show that it is important for policy makers to understand the implications of ending a period of self-employment for some people, which might include indebtedness, family disruption, or moving onto out-of-work benefits (for example when people with severe health conditions have no other options for work).

# 3 Patterns of working, income and expenditure

## Chapter summary

- 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.
- Some people might be at risk of under-reporting some activities (and hence also related expenses), including travel, buying stock or materials, planning future activities, back-up activities such as telephone and email correspondence, and cleaning.
- There were a wide range of different working patterns. Some people worked a regular number of hours throughout the year, but some variation in weekly hours was a common experience.
- 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.
- People received income in a variety of ways, including regular retainer payments or regular wages through working under agency arrangements. Some people providing services to a stable client base had fairly consistent streams of income. Others received income more irregularly either because their work was unpredictable or because they relied on the payment of invoices by others.
- A wide variety of expenses was reported, including stock and materials, hiring premises, travel, telephone and internet, and training and licences. Expenses were not necessarily spread evenly over the year. People who had recently started self-employment had sometimes had high initial outlay.
- 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.
- People sometimes use language to talk about their self-employed finances in ways not reflected in proposed regulations and reporting tools.
- Arrangements for reporting income and outgoings from self-employment under Universal Credit will need to accommodate the wide variety in types and timing of income and outgoings.

Self-employed tax credit claimants undertake a range of work activities which lead to different patterns of work, and different levels and patterns of income and expenditure. The relationship between hours worked, expenses incurred and income also varies. It is important for Universal Credit that this diversity is understood. Firstly, decisions will need to be made as to whether a claimant is gainfully self-employed, based on their hours and earnings. Understanding likely working patterns and how hours relate to earnings, including how they may vary over the longer term, will therefore form a key part of any such assessment. Secondly, it will be important that self-employed people

are enabled to describe how they work and the way in which activities generate income in ways that reflect the formal requirements and language of Universal Credit, both when completing the application form and in interviews. Finally, it will also be important that gateway interviewers understand variation in working patterns, and how income is derived, in order to discuss with people whether there is scope to increase their income.

Findings in this chapter provide useful insights here. We look in turn at patterns of working among the people in the study group (Section 3.1) including what counted as work and demands for services and products, and opportunities for working; patterns of working hours (Section 3.2); ways in which money came in as a result of activities and patterns of income (Section 3.3) and the expenses incurred in order to carry out activities (Section 3.4). In Section 3.5 we present a number of case examples from the study group that illustrate some of the complexity in the patterns of working, and income and outgoings experienced by self-employed people.

### 3.1 Patterns of working

#### 3.1.1 What counts as work?

Interviewers asked people what their work involved, encouraging them to think about all the activities that went into the way they worked and took up their time. Accurate reporting here will be essential in assessments for Universal Credit of the amount of work people are doing, and will also help people focus on all their expenses.

People's initial response to being asked what their work involved was often to describe the service or product as it was offered directly to customers, for example cleaning people's houses, teaching music, or running a shop. It was not unusual for people to make no mention, initially, of the time spent on preparation and back-up work necessary to offer the service or product. Our findings suggest that, without prompting, some people will not think of reporting fully the following components of their work.

#### *Time spent on telephone or email*

Some kinds of work depended on considerable use of telephone or email, for example responding to enquiries, and negotiating customer appointments, jobs, sales or deliveries of supplies. Much of such work was done from home on a landline, because respondents often switched off mobile phones while out at work or driving, needed to keep telephone costs down, or needed their records and documents to hand. 'Waiting in for a phone call' or making calls after office hours was sometimes essential.

#### *Travelling*

Travelling was often an important part of work. People with longer experience of self-employment, or using a van or car to visit customers or transport products, were usually used to recording their mileage and vehicle expenses, and travelling time. However, people with less experience, or building up their business, sometimes omitted mentioning until prompted some of the time spent on travel, including travel to the place of work, to buy materials, deliver goods, place advertising, or attend marketing and networking events. Not everybody had access to a private vehicle, and some people were using buses and taxis for some of these journeys, including people providing services in clients' homes. There could be substantial journey time and expenditure. People who combined business trips with personal errands, for example taking children to school on the way to a business appointment, sometimes said it was hard to know what part of the journey counted as work.

### *Essential 'back-up'*

Many forms of work required considerable back-up activities. Cleaning and maintaining a vehicle, equipment or tools, and laundry of overalls, uniforms, towels and mats could be substantial tasks, for example for people providing personal care services or pet care, or transporting outdoors equipment. Child-minding at home involved cleaning rooms and equipment after children left, and getting things ready for the following day. Some people spent time on additional training, learning new skills and techniques, or gaining new knowledge to enhance and extend working capacity. Until prompted, not all such people thought to mention such activities as part of their work, especially those new to self-employment.

### *Essential administrative work*

People with more experience of being self-employed perceived administrative tasks as a key part of their work. Some described regularly keeping one morning free to send out invoices, pay bills and do accounts. However, people currently doing only a small amount of administrative work, and people who had just started in self-employment sometimes described dealing with correspondence or book keeping on a day-to-day basis as required, during personal time at home.

### *Thinking, practising or trying out ideas*

People who spent time on getting ideas, trying things out, writing or composing, or practising music said it was often not easy to say how long they spent on this part of work which often went on around other responsibilities and tasks. Clear distinction between 'work' and 'non-work' activities did not match some people's way of life.

Overall, findings suggest some self-employed people are likely to be at risk of under-reporting the amount of work they do, and also possibly their expenses, unless prompts and suggestions in Universal Credit application forms, on-line income reporting schedules and during gateway interviews enable them to describe all the activities that go into their work. Those particularly at risk include people just starting their enterprise, people fitting some work activities around family responsibilities, people making journeys or carrying out activities which include personal and business objectives, and people whose way of life does not involve clear separation of work and non-work activities.

## **3.1.2 Demand for services and products, and opportunities for work**

Under Universal Credit, decisions will be made as to whether people are engaged in gainful self-employment, and when this begins and ends. Changes in demand impact on the work people do and may result from a range of factors, including predictable seasonal dips, and unpredictable and irregular dips in demand, as well a decision to leave self-employment. An understanding of how demand varies over time for self-employed people will therefore be important in making decisions about whether people's self-employment is gainful.

People in this study group explained how their working patterns were influenced by the demand for their services or products, and the opportunities for doing work. Some such influences were fairly predictable, but some kinds of work depended on responding to largely unpredictable (and sometimes only occasional) demands and opportunities. The different patterns of demand within the study group are summarised below.

### *'Open all hours'*

People with shops, restaurants and small high street businesses had regular opening times each day, and some stayed open for long hours during evenings and weekends to pick up trade. Taxi drivers also described having to be 'on call' or 'out on the road' all the time, waiting for fares.

### *Weather and daylight hours*

Working outdoors, for example on construction and gardening, could be impossible in bad weather. This limitation was greater during winter months, but also extended into wet weather periods throughout the year.

When work was done outdoors, long hours of daylight in the summer generally enabled longer working hours when demand for work was high but, again, wind and rain affected opportunities to work.

### *Seasonal patterns in demand*

There were many examples of different ways in which there were seasonal patterns of demand for services and products, and opportunities for working. There were dips in demand for 'luxury services' after Christmas when customers had less money to spend, dips when customers were on holiday, for example in summer months and the skiing season, dips in school holidays for people providing school-linked services, and dips in demand for some medical services during the summer.

On the other hand, seasonal increases in demand affected people whose customers wanted products and services in the months leading up to Christmas and festivals, or the summer wedding and holiday season. By contrast, there were some increases in demand immediately following Christmas for people whose customers started 'new year' projects. Demand for accountancy and book keeping followed the patterns of the financial year and VAT reporting. Taxi drivers, including those who had to be out on the road all the time, said the actual number of fares they took generally had a seasonal pattern.

People with experience of such predictable patterns of opportunity had some capacity to plan ahead. Some said they planned their own holiday times or booked places on training courses to keep up skills at times when demand was lower, and some were able to coordinate activities with partners who had different working patterns. Segmenting different kinds of activities was important for some, for example those who had a few peak selling times at craft fairs or engagements at festivals had to work hard during other times to make new stock or creative output. Among people who had started self-employed work more recently, some said they were still learning some of these patterns of demand and opportunity for work which would influence the way they worked in the future.

### *Unpredictable opportunities*

In contrast to patterns of demand and opportunities that were fairly predictable were those that came occasionally and sometimes quite unpredictably. There were professionals and consultants in the study group who said they had to respond immediately when there was an opportunity or they received a request for work, but this might happen only once or twice each year. Trades people might be approached suddenly for a valuable 'big job', and it took experience to manage such an opportunity, but not lose customer base by refusing smaller requests. Not knowing what opportunities there might be was one of the problems described by some people who had started self-employed work during the past year. Some were finding it very hard to generate work, but others had been surprised by high levels of interest in their product – in both situations, planning ahead was hard.

## 3.2 Patterns of working hours

The explanations in Section 3.1 of the various components of activity and how work could be predicted and planned, or not, are important in understanding people's pattern of working hours. For Universal Credit, the calculation of actual working hours and the assessment of scope for increasing productivity and earnings will be important parts of the gateway interview. We therefore asked people to think across everything that went into their work, including things like travel, administrative work, buying, back-up cleaning and maintenance, customer negotiation, and time spent creatively on writing and composing, and tell us how many hours they spent in a typical day.

To some extent, levels of work activity and input measured in number of hours, days or weeks reflected the patterns of opportunity just described. This was seen most clearly among people like the outdoors workers – winter weather stopped brick-laying and not much gardening happened in bad weather. However, a more common pattern was that drops and surges in demand and opportunity had some effect on hours, but there was also some levelling out by other factors so that hours worked did not show big peaks and troughs. We explain different ways in which this happened as we go on to report working hours.

People in this study group fell into five main groups, with:

- Regular, predictable hours;
- Generally regular hours, with occasional increases;
- Large peaks and troughs in working hours;
- Some dips and rises in hours, but not extreme;
- Working hours hard to quantify.

We go on to look at each of these groups in turn.

### 3.2.1 Regular, predictable hours

People who said their working hours never changed included the shopkeepers, open all the time; high street business owners who kept opening hours and did back-up work in the evenings; taxi drivers who took cars out for regular shifts, and some professionals who had offices or work stations at home, in which they worked on set days. Also in this group were some people regulating their time to fit in with family responsibilities, as described in previous sections. The highest regular weekly working hours were described by shop keepers (74 hours), a professional working at home (45) and people who were starting new ventures (35). The lowest regular hours were five to eight, described by a family's second earner; 'a few hours' by somebody working up a craft skill, who had a working partner; and six to eight hours worked by a franchisee, who had a second job as an employee.

### 3.2.2 Generally regular hours, with occasional increases

Some people said they generally worked fairly regularly, but would put in more hours if the opportunity arose, or if they needed to complete a job. Included here was a taxi driver who did regular 30 hour shifts but would gladly take an extra journey if offered. A professional regularly worked 16 to 20 hours, but had occasionally done 40 hours for a 'one-off' job. The timing of such increases was largely unpredictable.

### **3.2.3 Large peaks and troughs in working hours**

Construction workers and others working outdoors described large peaks and troughs in working hours. These were expected. Sub-contracted men worked 40 hours and more during summer months, but saw this go down to ten and sometimes none at all in the winter. Depending on the nature of their contracts, some men looked for temporary work as an employee during January and February, but this was not always available.

### **3.2.4 Some dips and rises in hours but not extremes**

Some, but less extreme, variation in weekly hours was a common pattern, reflecting the variation in demand, nature of work and patterns of activity already described. Typical examples were build-ups from 30 to 40 hours, and from 12 to 20 in the months leading up to Christmas, for people whose service demand or sales peaked towards the festival period. More customers wanted hairdressing and more items were sold as gifts at this time of the year. In work linked to the financial year, an increase in April from five to eight hours to 12 was described.

For experienced self-employed people, such dips and rises were fairly predictable, managed, and made to fit around family circumstances. There were dips from 32 to around 24 hours or fewer during school holidays for a lone parent who wanted more time with her child.

Much less predictable were the dips and rises related to health conditions. Pain, exhaustion and other symptoms sometimes substantially reduced what could be done. One person with deteriorating health was currently working only around three hours each week.

### **3.2.5 Working hours hard to quantify**

Some people found it hard to put a number of hours to their self-employed work. These were generally people who worked in more than one kind of self-employed work (one person had four different kinds of work) and people who combined self-employment with working as an employee. For some parents, self-employed work was fitted into the gaps left between their waged work and their family responsibilities. Others who found it hard to quantify their hours were people whose activities did not fit so easily into traditional concepts of the division between work and private time, as described in Section 3.1.1.

### **3.2.6 People's capacity to increase their amount of work**

This section has discussed levels and patterns of hours of work. Questions arise of whether, for Universal Credit, some of the patterns of work reported would see people moving in and out of gainful self-employment. We did not specifically ask people for their views here nor did we know what decisions would be made about hours that would be expected from each respondent. However, we do have some information which could help inform policy, as follows.

#### *How periods of low activity match a definition of gainful self-employment*

Some people described how they had periods of little or no activity in their self-employed jobs when in theory they could be undertaking some other form of paid employment. However, this was not seen as a viable or sensible option for some people. For example, some construction workers told us that their main contractor expected them to be available during the winter months for what work might arise. This prevented them from taking temporary employee jobs. They had to stay 'available' in order to safeguard their position when work did become available.

In many kinds of work people had 'slack' periods during which they spent time in a variety of ways that contributed to the continuance of their self-employment. For example, some people working as consultants described having only one or two direct requests for work during the previous year which left them with 'unpaid' time that they used to maintain their readiness for future opportunities (by doing business research, knowledge building and networking). In other kinds of work, when demand for goods or services dropped, people kept up-to-date by doing training courses, and going round to look at what was happening in their markets.

Small shops kept open for long working hours in hope of customers, although sales in the evenings were often low, and in periods of slack demand, people worked on websites and marketing materials, or renewed equipment and maintained tools.

### *Fitting self-employment around health and caring*

Also to be considered are elements of choice of working hours. Most of the determinants of working hours described above are related to the nature of the work. However, there were also determinants related to choice and personal circumstances and we have described already some people whose **health condition** put limits on working hours. These included people with chronic health conditions that much reduced their capacity to work. There were also some people who managed their days so that they did not increase health problems.

Other determinants of working hours centred round **caring** for families. Some respondents said it would in theory be possible for them to do more of their self-employed work, for example having more customers or working longer hours, but they could not then have cared for their family as they wished. Some women with children for whom family life was a priority therefore made conscious choices about the amount of work they did and when they did it. Such people said they chose to work part time and concentrated their work into school hours, evenings or specific days of the week. In some families, partners' working patterns were also factored in. Some had found that an additional part-time job as an employee suited their circumstances better than extending their self-employed hours.

Among those who had made decisions to limit their hours of work there was some awareness of the tax credits and income-related benefits rules. For example, lone parents without a second earnings stream were being careful to regulate their work to keep above 16 hours weekly. Some people met the hours requirements by combining self-employed activities with a job as an employee. One person regulated the amount of self-employed work done to maintain entitlement to Carer's Allowance. Universal Credit rules take account of the impact of health conditions and caring responsibilities on the hours which people may be expected to do other work.

The chapter goes on to consider how these patterns of hours are reflected in income flow, and levels of earnings from the self-employed activity.

## 3.3 Patterns of income

Universal Credit for self-employed people is designed around the concept of monthly cash flow and it is important to understand how this will fit the patterns of income of self-employed claimants. This section provides information about the ways in which work brought money in for people in the study group, and the patterns of income flow. The section following then looks at the patterns of expenditure incurred.

### 3.3.1 Receipt of payment and fees

Receipt of payments and fees for services was widespread among people in the study group, including people making charges for home-based services like cleaning, professional and medical services, hairdressing and teaching. Some people charged hourly rates for services, while some had fixed fees. Payments for services often followed immediately, for example customers for hair-dressing paid at the end of the session; clients for home cleaning services left payment in an envelope for the cleaner to take away. Payment for pet care was made when pets were taken back from walks. These kinds of payments were usually made in cash or by cheque, and not everybody issued receipts. The pattern of receipt often reflected hours worked, but this was not always the case, because levels of productivity could vary. This point was explained by several people, as follows.

There were several occupations in which, during winter months and holiday periods, **it took longer to do work** that could be done more quickly at other times. Travelling to customers' homes and work locations took longer in bad weather and periods of traffic congestion. For example, customers for a mobile personal service made fewer appointments in January and February, but it took the business owner longer to get to their homes. Her working hours did not show a big reduction, but takings were lower. Others explained that communications, correspondence and negotiations could take longer in holiday periods, when administrative offices were short staffed and key personnel were on holiday. So it took longer to do work, output decreased and fewer payments were received although hours worked did not show the same reduction.

By contrast, in some occupations **economies of scale** meant that more could be achieved in the same amount of time. When travelling was easy, two customers living close together could be visited in the time taken to go to one at other times. Child-minding hours were the same, whether one or two children were in the home. In situations like this, increases in earnings did not reflect working longer hours.

Another way of working among people who received payments for services was to agree a price for the job in advance, or to give an estimate for the eventual bill, for example in work involving repairs, and home and garden maintenance. Payment periods then reflected the length of the job, and sometimes also reflected customers' readiness to pay bills. Self-employed people who received payments in this way sometimes asked for deposits before starting work or might issue an invoice for part-payment while the work was going on. Maintaining regular income could be challenging in this kind of work and hard for those new to self-employment. Working on jobs for several customers over the same period of time, with different completion dates, was one way in which more experienced people tried to smooth income patterns.

People who received large but infrequent fees for professional work in the world of finance and commerce said that payments sometimes came as much as a year after completion of the work.

### 3.3.2 Regular income and 'wages'

Only very few people in this study group received regular income through a 'retainer fee' from a client. Being able to rely on a regular retaining fee did provide some financial certainty, although amounts paid were low. A person with professional qualifications in a specialist area received a small monthly 'retainer', through bank transfer, to recognise the need for continuous work in order to be ready for specific demands that might come at unpredictable times.

People whose situation was rather similar to that of an employee, in that they worked for one main 'employer' at an agreed hourly rate, included construction workers, and reception staff. It was common here for such people to talk about their 'wage', although they recognised that technically they were self-employed. For this group of people there was a direct link between income and hours worked, with regular payment dates and often 'wage slips' to notify bank transfers.

### 3.3.3 Income from sales

There were many examples in this group of people whose income came from selling goods. Included here were the shop owners, people with food sales outlets, on-line traders, and people who sold goods privately, in markets, and at events, such as craft fairs and arts festivals. Payments generally followed sales, but patterns of income receipt varied considerably, according to the product and the patterns of demand and opportunity, as described in Section 3.1.2. Thus, shop keepers took payments throughout each day, but other people saw seasonal falls and rises in payments which reflected seasonal swings in demand. For such people, income receipts often reflected hours worked during earlier periods of the year, when they were building up stock during periods of slack sales. Those who took orders in advance for specific items, such as artists commissioned for a particular picture, might expect to receive full payment only after working for several months. Such payments reflected many aspects of the undertaking – not only hours worked, but also skills and techniques of the artist.

### 3.3.4 Commission arrangements

Across the group, people were working to a variety of commission arrangements. We described earlier the ‘retaining fees’ paid to professionals. Other arrangements included commissions on sales and service contracts for third parties; commission on sales from vending machines; commissions on club memberships; and commissions paid on outcomes of third party negotiations. There were rarely simple relationships between these payments and hours worked, and there were no clear patterns within the diverse arrangements. Some of the latter arrangements, in the world of finance and commerce, were complex. Those people who received such commissions understood the arrangements, but some said it could be hard to explain them, and there may be challenges here for income reporting and assessment for Universal Credit.

To conclude this section on patterns of income, it may be useful to bring together what was learned about the relationship between working hours and income. Links between low earnings and low hours were clearest among people working fewer than 16 hours, including some whose partner was the main family breadwinner and some people whose health was deteriorating. The major dips in working hours experienced by outdoors construction workers were also directly related to low earnings. An hourly paid construction worker generally received £300 for a 40 hour week, and more in the summer months, but earnings fell back to around £75 in between November and February, and sometimes none in January. However, low earnings were not always linked with low hours of work. One of the professionals who regularly worked 35 hours from a home office had not achieved a new commission during the past year, and the profit and loss account showed trading at a loss. Among people who were just starting their self-employed enterprise, one person’s total income for the first six months had been £140. There were other examples of extreme low earnings among new starters working more than 16 hours weekly. Although there were some links between hours worked and patterns of income, aspects such as the nature of the product or service, and demand and opportunities were often just as important.

## 3.4 Patterns of expenditure

The Universal Credit assessment of self-employed earnings requires people to report the costs and expenses related to their work on a monthly basis. In these research interviews we asked people to think across all the different ways in which they paid out money in order to do their work, and we report here what they said. At a later point in the interview we showed people a printed version of the draft online reporting form, and asked how the monies they spent would fit into the categories offered, and their answers here are reported in Section 5.2.4.

### 3.4.1 Buying stock and materials

Many people had to buy things for their work, both regularly and occasionally. Those who said they purchased stock and materials regularly (for example every week or month) included shop keepers, people running food outlets, and some people whose manufacturing work depended on having a stock of fabrics, stationery and art materials. Extending business activity often depended on being able to build up materials and stock, for example to be able to offer a wider range of items for purchase. However, if income was low it was hard to increase stock. A person making items of clothing hoped to extend the range, which could lead to increased productivity and income, but this would depend on having more cash available than at present, in order to buy different textiles. In some longer established businesses, stock was replaced as required and there was some balance between stock purchase and sales, or more regularity in expenditure. An example here was a long established hairdresser who just replaced chemicals and shampoos as the supplies ran out, in a weekly shopping trip and occasional online ordering.

In the study group there were also people who passed on costs of materials directly to customers. For example, gardeners passed on to clients the costs of paving materials, trees and shrubs they had paid for themselves. There could be long delays before getting this money back, which made it hard to manage cash flow.

### 3.4.2 Work expenses

Only one person had no work expenses, being collected from home and driven to the workplace and back, with no financial outlay at all. Everybody else spoke readily of the various costs and expenses related to their work. Frequently mentioned were vehicle fuel and maintenance costs. Several people who drove cars or vans on long journeys to work locations said there were some months when fuel costs outstripped income. People without cars spent weekly on bus and taxi fares. Costs of travel for training events, networking, marketing and stock purchase were also sometimes high.

Paying for hire, heating and maintenance of premises away from home was a major regular expense for some people, while some made claims for the expense of use of their home in their end of year accounting and tax assessments. A few paid wages to employees, with additional expenses of staff uniforms and training. Others kept up knowledge and learned new skills in training courses and local events for which they had to pay. A range of professional licensing and accreditation fees were being paid, and several people had business insurances, and public liability insurance. The point was made that annual payments for licences and insurances often all came due in the same month, reflecting the time at which businesses had started.

Other frequently mentioned regular expenses were telephone and broadband, mobile phone contracts, website maintenance, advertising materials, office materials, postage, cleaning materials and for one person, food and drink for children cared for. These expenses tended to show a fairly regular pattern. However, the need to replace an essential washing machine, professional standard iron, children's play equipment, broken or stolen tools, musical instruments or protective clothing meant occasional big outlays on essential items, sometimes unexpected.

Bringing together the different ways described in which monies came in and went out it is not easy to identify distinct groups by the patterns or levels of their overall cash flow. (Such groupings, if they exist, might have been useful in the process of assessment of earnings for Universal Credit, or in gateway interviews about potential for increasing profits). Certainly there were patterns of incoming monies, and of outgoing monies. Sometimes these patterns coincided or reflected each other for an individual but often did not. The simplest cash flow situations were those where cash payments for services were received immediately, and reflected fairly regular working hours, and where expenses were also fairly regular and defrayed immediately. An example might be a cleaner, working three

days a week with regular clients, who paid for weekly bus fares to get to jobs, and replaced cleaning materials as needed. Such simple situations were unusual in this study group. There were often falls and rises in income, with a quite separate pattern of expenses. People who had recently started had sometimes had high outlay, but currently had low income. Among longer established businesses, income was sometimes unpredictable and it was not unusual to have months when lower income was matched by higher outgoings. The group included people whose annual profit and loss account showed them trading at a loss.

We end this section by drawing attention to the language used by self-employed people to describe income and cash flow. It will be important that the language used on application forms for Universal Credit and in discussions in gateway interviews enable self-employed people to record appropriately and explain fully their incomes. As found in previous research with low-income self-employed people, terms, such as 'takings' and 'turnover' are often used, for example by taxi-drivers and people running high street businesses. In this study group, shopkeepers also spoke about 'drawings', the amount their accountant told them they could draw from their business for personal use each month.

### 3.5 Case examples of diversity in patterns of working, and income and outgoings

In this chapter we have presented, in separate sections, an analysis of the diversity in the patterns of people's self-employed work and in their income and outgoings. In this section we present two case examples of people in the study group to show how this diversity is manifested in individual lives.

The first example describes the experiences of a claimant starting a new self-employed venture that gave her the opportunity of combining work with family life. Her work was affected by the seasons and the weather, and her income flow from fees for service was not predictable. Because this was a new venture her business had not settled down and was not yet financially secure.

#### **Case example 3 – The seasonal worker**

Ms C, in her 40s, had recently started up as a sole trader, offering gardening services. She had decided to branch out on her own after working as an employee in a successful horticultural business. Her partner had his own separate employment, but was ready to help her with the IT and accounts work that would be involved. An advantage for her of working as self-employed was that she had some flexibility in contributing to care of a relative with a health condition.

Ms C's new venture had started well. During the summer months she had been fully occupied, working long hours on a big contract. She had already had to turn down some requests, as she could not work any harder. She kept weekends free to recuperate from the physically demanding work.

She currently charged standard fees for gardening, and had not had any problems with late payments. At this stage of business, however, even in the peak summer season, when she had been fully occupied, there had been some months when expenses of buying tools and supplies, and paying for travel had outstripped her earnings.

There were uncertainties about forthcoming winter months when she expected a lower demand for gardening services. In any case, less daylight and spells of bad weather would mean she could do less work. She expected income to fall. But it would be important to keep her customer base, which might mean taking whatever small jobs were on offer. Travel expenses might still be high – going to more dispersed locations, more frequently, but for smaller fees. She expected to have to work through a whole year's cycle to get a good picture of how business might be sustained, with variations in opportunities to work and in income.

The next example illustrates how a business partnership of husband and wife running a small shop managed their income and outgoings.

### **Case example 4 – The business partnership**

Mr and Mrs D owned a small shop. They worked regular hours and each took drawings from the business accounts that constituted their monthly ‘wages’ regardless of the actual income and outgoings for that particular month. Their income came from sales of goods and commission generated from providing cash machine and other financial facilities.

Their income was described as highly variable depending on sales and the timing of payments from the cash machine and other services. Variation in sales was reflected in their outgoings to replace stock. They also had a range of other outgoings that were more or less predictable (in both their amounts and frequency) including wages paid to shop staff, utility bills, fuel (to visit cash and carry outlets for stock), repayments on bank loans, and insurance payments. Other outgoings were infrequent though could be planned such as replacement staff uniforms and advertising leaflets. Mrs D kept routine records of income and outgoings which were sent to an accountant every three months for VAT purposes. The accountant also dealt with the end-of-year tax returns and tax credit renewal. These arrangements all suited the shop owners who liked the relative stability that tax credits and annual accounting contributed to their lives.

Nevertheless, the low financial returns and arduous hours of owning a shop had led them to the decision to sell the business at the earliest opportunity.

## 3.6 Discussion

Findings in this chapter provide further perspectives on the heterogeneity of activities within self-employed work, and the highly variable and sometimes complex relationships between working patterns, incoming monies and expenditures. In some cases, it will be challenging for DWP to decide whether people are in ‘gainful employment’, and it will be necessary to take into account both the nature of the work, and time parameters. Questions might arise as to whether someone working seasonally or who is liable to periods of ‘downtime’ when they do not work at all can be considered as moving in and out of gainful self-employment.

In order for decision making for Universal Credit to be consistent and fair, decision-making staff will need full training in the nature of self-employed work, and application forms and on-line reporting tools must enable people to explain fully their circumstances.

Communication between self-employed people claiming Universal Credit, DWP staff who make decisions, and staff who conduct gateway and quarterly interviews is likely to be very important. One aim for Universal Credit is achieving understanding and simplicity for claimants. However, the heterogeneity of the self-employed population means that too great an emphasis on simplicity in rules, enquiries and explanations may disadvantage some claimants. A good example here is in the proposed online income reporting tool, where findings suggest that more prompts and suggestions would be helpful, to fit different kinds of work. Some people will need more help in understanding that measures of ‘turnover’ and ‘drawings’ do not fit the way DWP requires information.

Findings suggest also that there is a risk of some self-employed people under-reporting the extent of their activities, because they do not immediately identify everything they do as ‘work’ or all the time they spend on various activities as falling within ‘working hours’. Prompts, suggestions, and reminders will be necessary within applications, reporting tools and interviews so that working hours are fully recognised and taken into account. Linked with this, expenses may also be under-reported

unless claimants are helped to think across all their activities, which could wrongly inflate their reported cash balance, with implications for entitlement to benefit.

Overall, findings point to the need for high levels of training, and good understanding of the nature of low-income self-employment among staff who will engage directly with claimants for Universal Credit and among decision-makers.

## 4 Current experiences of tax credits and financial record-keeping

### Chapter summary

- The experiences of people in claiming and using tax credits were mainly positive. While there were some instances of people having problems, and a slightly greater number of respondents having to deal with an overpayment, 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.
- Most respondents said their tax credits went towards household expenses only and kept separate accounts for their business and for their personal use. Some kept a single account from which they met their household and their business expenses. No-one said they earmarked tax credits solely for business purposes.
- 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 (such as manual occupations and some service-based enterprises).
- 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.
- The draft Universal Credit online income reporting tool was received positively by most respondents though there were a number of questions raised about the meaning and definition of various terms, such as 'stock', 'business costs' and 'expenses'.

All 45 respondents were in receipt of tax credits, but the length of their claims varied considerably. Some were in their first year of claiming and receiving an award based on estimated self-employed earnings only. Others were in their second year and had had one re-assessment and reconciliation based on their first year's earnings. The members of the study group who had been receiving tax credits for over two years had all had at least two annual re-assessments.

Respondents were all asked about their experiences of the process of claiming tax credits (including how they kept up the necessary financial accounts), and their use of the credit in order to learn any lessons for the structure and administration of Universal Credit in the future. They were also asked whether they would use an online tool provided by the Department for Work and Pensions (DWP) that would allow them to keep systematic records.

## 4.1 Experiences of claiming and using tax credits

Most people in the study group said that they had not had problems in either making an initial or a subsequent claim for tax credits. When asked what information they had been asked to supply to HMRC people still within their first claim period could not recall being asked for any specific information at all. (This is consistent with first awards being made on an estimate of future earnings for which no documentation would exist.) Among those who had been re-assessed, some recalled supplying profit and loss accounts in particular; others referred variously to having supplied details of partners' earnings, tax returns, proof of earnings and outgoings, timesheets, business plans and passport information. None of these respondents reported any difficulties in supplying this information. An equally common response from the respondents who had made re-applications for tax credits was that they had not been asked to supply any written information at all, but had completed their claim by telephone.

There were a couple of instances of claims not running smoothly, for example, when the status of redundancy payments was unclear leading to a dispute about the amount of the award, and because a claimant had not completed the application form correctly.

Some people had applied for mid-year adjustments of their awards (for example, because they had started to incur childcare costs, and because they had taken on some separate paid work as an employee). Again no problems were experienced in getting their awards adjusted.

The main problem reported in receiving tax credits was having an overpayment and consequently having to repay it. This was a frequent experience in this group of people, and in some cases, repayments were still being made for overpayments of tax credits derived from earlier periods of work as an employee. Having to estimate earnings for initial claims had caused anxiety for some claimants who feared they might be asked to repay money at some stage.

It was interesting that few people who had experienced an overpayment made a connection between monthly reporting and adjustment of tax credits and elimination of the problem of overpayments. One respondent who did understand the implication of monthly reporting was pleased that the possibility of overpayments would be removed under Universal Credit. In contrast, one person who was struggling to repay a four-figure overpayment was still adamant in his preference for the annual reviews under tax credits, because he valued the certainty and stability of income that an annual assessment provided.

When asked how they used tax credits, most people said the monies went towards household expenses only. Most people kept separate accounts for their business and for their personal use and had their tax credits paid into their personal accounts. Some respondents spontaneously listed how they spent their household budgets, including all the usual items that would be expected: food, rent, heating, clothing, household maintenance, gas and electricity, travel, social life, children's needs, school expenses, childcare. It was not the intention in the interviews to ask respondents for their views on tax credits (that is, the annual cycle of claims and the payment of regular, consistent amounts) because the policy decision had already been taken to move to monthly assessments and payments in Universal Credit. However, many respondents spontaneously mentioned the value they placed on stability and reliability of payments saying 'it's essential' or 'it's been a god-send'.

In contrast, some respondents did not have separate accounts but kept a single account from which they met all their household and business expenses. They did not identify any particular income (that is, from tax credits or from their self-employed business) with any particular type of expenditure. Some said that some of their tax credits would therefore probably be used for paying business costs, such as stock or equipment. No-one said they earmarked tax credits solely for business purposes.

## 4.2 Keeping accounts and financial records

Respondents were asked about their current practices for keeping business records and accounts. Responses were intended to give an indication about the extent to which the requirements of maintaining a Universal Credit claim would fit with how they ran their self-employed work, and whether they would have to make major adjustments to their usual recording and accounting practices.

The people in the study group fell into three broad groups. First (the largest group) were those who described themselves as 'organised' and kept records and accounts in a way that suited them. The kind of self-employed work conducted by people in this group varied, some needing fairly simple financial records (that is, there was a high degree of regularity in the income and outgoings), while other records were more complex (sometimes involving more than one self-employed job). Some people maintained computer-based record systems while others relied entirely on paper records. Not everybody used an accountant. Those who did have accountants for dealing with their end-of-year finances included people who had been in self-employment for relatively long periods (two years and more) but also some newcomers in their first year of trading. In summary, the members of the study group who appeared to keep well-organised records were highly heterogeneous. Those who were in more established self-employment had found ways of running their businesses that suited them. Some described simply being more comfortable with paper records and less comfortable with (and sometimes averse to) working with computers.

The group of respondents who seemed less well organised tended to be in the early days of trading and had not yet settled into established patterns of working. Others seemed either never to have been very systematic in their record-keeping (for example, those relying on the 'biscuit tin' or the 'shoe box' method of data storage) or to have let systems lapse for some reason ('getting behind with things').

The third group of respondents seemed to have very unsystematic, or almost non-existent, ways of dealing with their self-employed finances. There were only a few people in this group, one of whom worked on a cash basis only (with no associated paperwork and few outgoings), and another who stated simply that she 'didn't keep accounts'.

## 4.3 The use of accountants and other external help

In the study group of 45 self-employed people, around one-fifth of the respondents said they used a professional accountant for their business. These were generally people either in self-employment that would be classed as professional or people operating the larger commercial enterprises, such as shops and restaurants. Most were among the medium to high earners and most had been in business for over two years. A small group of low earners had specific reasons for using an accountant, such as not having English as a first language and struggling to understand the finances of the business and reporting requirements, or wanting to avoid problems experienced in the past of getting a large overpayment of housing benefit. The small group of people who had employed an accountant within two years of starting self-employment were:

- the person mentioned above with the overpayment experience; and
- a person who continued to adopt practices she was used to when previously running a high street business with a business partner.

Also in the study group were several people who relied on the help of family members trained in accountancy to manage their self-employed finances.

There is evidence emerging that suggests people in the early years of self-employment and those on low earnings are less likely to have an accountant. This might accord with expectations, but carries the implication that new claimants of Universal Credit are probably likely to be dealing with their finances alone, without professional assistance. Furthermore only one of those respondents with an accountant said that they might involve them in providing evidence for monthly reporting. One respondent referred to the high cost of hiring an accountant and said that using one on a monthly basis was a cost that the business could not bear.

There is thus some evidence here that the policy intention of designing procedures that do not necessarily require input from professional accountants largely matches how self-employed people would actually deal with the ongoing monthly requirement to report income and outgoings. The evidence also suggests that reporting procedures need to be geared towards inexperienced self-employed people who lack specialist accounting knowledge or access to professional help.

#### 4.4 Using IT and views on a DWP financial management tool

As mentioned above, people in the study group varied widely in the methods used to keep their business records. Some were content to use paper-based methods as they were seen as sufficient for the purposes of dealing with their tax and tax credit business. Others took advantage of the opportunities provided by standard computer programmes, such as Excel. Only one person in the study group used a dedicated accounting package in managing their self-employed finances.<sup>7</sup>

As mentioned in Chapter 1 one of the research questions that DWP were interested in pursuing was the extent to which there might be a demand for an official online tool that would be used by self-employed people to record their income and outgoings, and be the basis for completing the online monthly Universal Credit reporting form. Respondents were therefore asked if they would be likely to use a DWP online tool to help them manage their business income and expenses if one were to be developed and made available.

This possibility was met with interest and some enthusiasm by a minority of the study group. Included here were some respondents who were in the early days of trading and had not yet set up routine record-keeping arrangements, and those who were already well organised, but recognised that Universal Credit would create new demands on them that they would have to respond to. They therefore welcomed the possibility of a dedicated tool to help them. Some of this latter group already used the services of an accountant at year end, but saw monthly reporting as something they would be doing themselves in future. No one in the study group said that they would engage an accountant to deal with their Universal Credit claim, while some made the point they would definitely **not** be employing their current accountant (on the grounds of cost).

Those who said they probably would not use a DWP tool included those who thought their business finances were simple and did not require anything more to be able to report what was necessary to Her Majesty's Revenue and Customs (HMRC) satisfactorily, and those who were content that their current use of computer-based record-keeping was already sufficient for their needs. As mentioned earlier, however, some people were simply not comfortable using computers and would not be interested in anything that DWP might make available to help them in the future.

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<sup>7</sup> This was *Visual Accounts*.

### 4.5 Discussion

Although most of the study group described themselves as ‘organised’ in their keeping of records and accounts there was widespread reliance on simple, paper-based methods of record-keeping. Overall, the evidence from people’s experiences of claiming tax credits and keeping financial records points to the need for procedures to be designed so that they can be managed by inexperienced, self-employed people who lack specialist accounting knowledge or access to professional help. 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.

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. This poses a possible communications/presentational issue if Universal Credit is perceived to undermine or threaten the stability that people value under tax credits and therefore their ability to meet essential living expenses. We return to this theme in Chapter 6 in the presentation of findings about the Minimum Income Floor and again in the concluding chapter.

There was some interest shown in using an online record-keeping tool should one become available in the future suggesting that it would be worth developing the tool further. Those interested included people in the early days of trading which suggests that a useful time to promote its use would be when people are discussing self-employment with a DWP adviser or a Work Programme provider.

# 5 Information requirements for Universal Credit

## Chapter summary

- 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 people felt 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 thought they would be able to meet most of the proposed requirements for the gateway interview while others said that only a few were possible.
- The sources of evidence of self-employment most frequently mentioned as accessible included lists of clients/customers, cash books, receipts from clients/customers, receipts for purchases and proof of tax registration with Her Majesty's Revenue and Customs (HMRC).
- Very few respondents said they had business plans, and some were unhappy with the idea of being required to provide names and addresses of their clients or customers, as they felt that this would be an unacceptable breach of confidentiality.
- 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 deadline for reporting income at the end of a month 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.
- 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.

The information and reporting requirements that will apply to self-employed Universal Credit claimants will differ markedly from the requirements under the current tax credit system. The principal changes will be:

- A requirement to attend a gateway interview in order to prove that self-employment is ‘gainful’;
- A requirement to report self-employment income and outgoings on a monthly basis within seven days of the relevant assessment period;
- A requirement to report financial information electronically through the Universal Credit website.

In this chapter we examine how the sample of self-employed tax credit recipients reacted to the prospect of these changes, in particular whether they felt they would be able to comply with the new requirements and what the likely impacts of compliance were. In Section 5.1 we explore responses to the gateway interview proposals and Section 5.2 reports on the study group’s responses to a regime of monthly reporting. As noted in Chapter 1 one of the research questions that we were asked to explore was how the proposed reporting arrangements would impact on the potential for misreporting (either intentionally or accidentally). Section 5.3 addresses this issue. Section 5.4 sets out people’s views on how their behaviour might be affected by the information requirements for Universal Credit.

We should note that it was not the intention in the interviews to explore views about the desirability of gateway interviews or monthly reporting since these are features of Universal Credit that are central to its design and operation. In contrast, the purpose of the interviews was to investigate the feasibility and impacts of the proposed arrangements.

## 5.1 The gateway interview

### 5.1.1 How the gateway interview is expected to work

As explained in Chapter 1, we explored people’s reactions to the gateway interview based on the information contained in the Department for Work and Pensions’ (DWP’s) explanatory memorandum to the draft Universal Credit regulations published in early 2012. (The relevant clauses of the final regulations published in December 2012 are reproduced in Appendix A.)

Initial thinking about the purpose of the gateway interview was set out in the memorandum on the draft Universal Credit regulations, as follows:

‘With the exception of those who are not expected to work because of their personal circumstances, claimants who declare that they have income from self-employment, or who are self-employed with no income, will be invited to a “gateway” interview. The claimant will be asked to bring evidence to the interview to demonstrate to an adviser that they are in gainful self-employment. For the purposes of Universal Credit, this means the claimant demonstrating that he/she is in organised, developed self-employment carried out in the expectation of profit, which is:

- Genuine – there is evidence that such work activity is taking place and is done by the individual who presents him/herself for the interview;
- Taking up the majority (that is, at least half) of the claimant’s work week – this would be 18 hours a week for claimants with no limits on their working time, but lower for claimants with caring responsibilities or disabilities, for example;
- Done with the intention of increasing the income received to the level we could expect the claimant to make if working full-time (for their circumstances).’

The memorandum made it clear that claimants making a new claim for Universal Credit and who were starting up a new self-employed business would be expected to attend interviews every quarter in the first year of their claim (the ‘start up period’). By implication, other claimants would be required to attend a single gateway interview only.

The memorandum also listed the types of evidence that might be accepted as appropriate and eventually be included in guidance (that is, rather than set out in regulations). The list was not intended to be exhaustive. In the research interviews therefore we explored whether respondents would be able to produce any of the following:

- Diaries of appointments.
- Lists of customers and suppliers.
- Proof of tax registration with HMRC.
- Marketing materials to secure new business.
- A business plan.
- Receipts for purchases/business expenses.
- Order and sales records.
- Bank statements.
- Cash book for cash income activity/transactions.

### **5.1.2 Respondents’ views on compliance**

The research interviews focused on respondents’ views about their ability to produce types of evidence that might be expected of them. When presented with the list of the possible evidence that might be deemed acceptable proof of genuine, gainful self-employment respondents’ reactions fell into three broad groupings. First were those who saw no difficulty in producing most forms of evidence (including a couple who said that they were confident of supplying everything). Second, was a group who said that they could supply some evidence, but not all items on the list. A small final group expressed some concerns that it would be difficult for them to produce more than only one or two pieces of evidence. Having said that, it was clear that most people saw it as reasonable to be asked for evidence in order to claim Universal Credit. And some spontaneously mentioned that having to show that self-employment is genuine is a means of guarding against fraud.

The sources of evidence most frequently mentioned as readily accessible included lists of clients/customers, cash books, receipts from clients/customers, receipts for purchases and proof of tax registration with HMRC. Very few respondents said they had business plans however, and some were unhappy with the idea of being required to provide names and addresses of their clients or customers, as they felt that this would be an unacceptable breach of confidentiality. People who supplied services of a personal (for example health-related) nature were particularly concerned here.

From the data it was possible to identify a number of possible factors that could partly explain the variation in responses. In general the ease or difficulty with which respondents said they could meet the evidentiary requirements listed was linked most closely with the type of work that was being carried out rather than the length of their self-employment or their level of income. Some types of business were more likely than others to generate specific forms of documentation. For example, people involved in small-scale manufacturing and selling had lists of suppliers and customers, receipts for income and expenditures, orders and sales records, marketing materials and bank records. Similarly, those in service occupations said they could supply diaries of appointments, lists

of clients, bank records and sometimes marketing materials (though not always receipts sales records). In contrast, people who relied on cash income from, for example, street entertaining or taxi driving, had no comparable source of evidence available to them. They provided services that were paid for in cash, for which they did not issue receipts (mainly because they did not need to and were rarely asked), and which they did not need to promote through marketing. Some did not use bank services, but conducted their business and personal finances on a purely cash basis.

Some respondents offered ideas on other ways in which the genuineness of their self-employed business might be demonstrated. These included websites and physical proof of goods manufactured. Some respondents thought that the best evidence was for someone to see them at work, and saw this as an effective counter-fraud measure.

Although not able to produce some of the items of evidence now, some people said it would be possible to produce them in the future, either by doing something additional to their existing practices (such as drawing up a business plan) or by changing the way they conducted their business (such as issuing receipts or keeping records of cash transactions). There did not seem to be strong objections to changing practices and a few respondents saw the opportunity of actually running their businesses more professionally and efficiently.

## 5.2 Monthly reporting of income and outgoings

### 5.2.1 Plans for monthly reporting

The DWP memorandum on the draft Universal Credit regulations explains that claimants will be required to report their self-employed income and outgoings on a monthly basis, and that this requirement is intended to allow monthly adjustments to payments of Universal Credit, to allow claimants to maintain simple records (which should help them keep a stronger hold on their business finances), and allow compliance without the need to employ an accountant.

To report monthly self-employed income claimants will be required to complete an online data collection tool within a period of seven days after the relevant assessment period. Failure to do so could result in a suspension of Universal Credit payments. The memorandum explains that the online tool will collect information for each assessment period on:

- income received from self-employment (cash in); and
- payments made for the self-employment (cash out).

There is further elaboration of what payments are to be considered ‘allowable business expenses’:

- Regular business costs (for example, rent, wages, operating leases).
- Stock purchased for business.
- Expenses (for example, electricity, telephone, business travel).
- Allowable one-off costs (for example, capital expenditure, finance leases).
- Income tax payments.
- National Insurance contributions.
- Personal pension contributions.

Chapter 3 described the kinds of payments which people in this study group were currently making.

### 5.2.2 Respondents' views on monthly reporting of income

In the research interviews, respondents were asked about their ability to comply with the requirement to report income and outgoings monthly and whether they would be able to do this within seven days of the end of the appropriate assessment period. The intention was to explore people's capabilities rather than their views on whether these requirements were desirable. Respondents were also shown a download of a draft of the online data collection tool and asked to comment on whether it was clear what was required and whether the categories of expenses made sense to them. (This download is reproduced as Appendix C.)

The responses fell into three broad groups according to how easy or difficult people thought they would find monthly reporting. The first group felt confident they would be able to comply with little or no difficulty. The second group thought that they would experience some difficulties in meeting the requirements at least in the short-term but, nevertheless, would probably be able to do so eventually. A third group said they would have considerable difficulties in meeting the monthly reporting requirements.

While these three groups emerged fairly clearly from the data, there was no evidence to suggest that age, sex, length of self-employment, hours worked, income level or type of employment had any bearing on the ease or difficulty with which people thought they could meet the reporting requirements. As we explain below, factors which did appear to be connected with people's perceptions of their ability to comply with Universal Credit reporting requirements were competence with computers and experience of using the internet, current accounting practices and patterns of income.

The largest group among the sample of 45 self-employed people comprised those who said they could comply with monthly reporting with little or no difficulty. This group tended to be comfortable with using computers for their business and in their personal lives. Using the internet held no concerns or fears for them. Some mentioned that they were already used to using the internet for dealing with their tax business (including VAT). Those who foresaw the least disruption were those who already followed a monthly cycle in their business dealings or in their personal budgeting. For them, monthly reporting of self-employed income and outgoings would fit fairly seamlessly into their current business practices.

Among those respondents who said they had some concerns or would experience difficulties in monthly reporting there were a range of explanations offered. For some, their concerns were not linked to the requirement to report monthly, but to their lack of experience or lack of confidence in using computers. Some explained that they did not have access to the internet at home. One person minimised her use of computers because of her dyslexia, though she could and did use them when she had to. Some of the respondents for whom English was not their first language also expressed concern that they would have to deal with a reporting regime that they would find difficult to understand. Having said that, they also reported experiencing comparable language difficulties with some of the demands of running a business and had found ways of dealing with these (usually by enlisting the help of family members, such as grown up children).

Others' concerns focused on the technical task of submitting income and outgoings data every month when their cash in was largely unpredictable and their outgoings were not regular. People raised a number of questions about how they would be expected to report fluctuating income and outgoings. For some people, thinking about their income and outgoings purely in cash terms, particularly on a monthly basis, did not match how they dealt with the finances of their business. They therefore saw the requirements of maintaining a Universal Credit claim as problematic. One respondent's self-employment was affected by his health, the weather and seasonal fluctuations

in the demand for his work. His income, which was always in cash with no accompanying documentation, fluctuated unpredictably. Reporting monthly online would not fit with his accustomed way of working.

To explore this issue further respondents were asked to assess the amount of time that reporting would take them each month. Estimates varied from 'ten minutes' to 'two to three hours', but responses did not seem to bear any relationship to people's type of self-employment. Only the longer estimates (in the two to three hour range) attracted the criticism that monthly reporting would be 'onerous' or 'a burden'.

For a small number of people in the sample, the difficulties they foresaw having with monthly reporting, whilst similar to those already discussed above, were perceived to be particularly severe. Included here were a person whose command of English was very limited, a person whose income and outgoings were perceived as particularly complicated, and a sole trader in her first year of operating whose basic business records were very rudimentary and not well organised.

### 5.2.3 Respondents' views on the seven-day reporting deadline

Meeting the requirement for reporting monthly data within seven days of the relevant assessment period was reported as feasible and largely unproblematic by most respondents. However, there was also recognition that there was a wide range of circumstances in which people might find it difficult to meet the seven-day deadline.

Examples given of potential causes of delay in reporting included:

- Temporary sickness.
- Effects of long-term health conditions.
- Holidays, including religious holidays during which work was not permissible.
- Contingencies, such as family emergencies.

Some respondents also drew attention to the uneven pattern of their working hours which meant that at certain times of the year they might be working very long hours for seven days a week, during which time it would be difficult to find the time to deal with the reporting deadline.

There was concern expressed by some respondents that they would be penalised if they failed to meet the deadline.<sup>8</sup> One respondent understood that late reporting might not necessarily lead to a loss of Universal Credit. However, she was concerned that a late payment would create difficulties as she currently relied on regular payments of tax credits in order to be able to manage her household budget.

Overall, although most respondents thought that reporting within seven days was feasible there was also a desire for some flexibility before any form of suspension or cancellation was implemented.

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<sup>8</sup> The DWP memorandum on the draft Universal Credit regulations stated that 'If the claimant does not report his/her income within seven calendar days, he/she will receive notification that his/her household payment has been formally suspended and will be terminated if the missing income report is not received within four weeks of that date. If the claimant submits the missing report within the four week period, the suspension will be lifted and the payment made.'

### 5.2.4 Respondents' views on the online reporting tool

As mentioned earlier, respondents were shown a printed version of the draft online monthly reporting form. To summarise, the form requests information on:

- Money earned:
  - All income from self-employment.
- Money spent:
  - Regular business costs.
  - Stock.
  - Expenses.
  - New equipment.
  - Tax.
  - National Insurance.
  - Pension contributions.

Most people responded positively to the draft reporting tool. It was generally thought to be straightforward and clearly laid out. There were a number of questions raised however, that might have implications for the content of explanatory or guidance material that will be produced for self-employed people by DWP.

The short explanations in the draft tool itself were not always enough for people to be clear about exactly what information was required of them. Some people were confused or unclear about specific items of information, particularly when they were not applicable to their own type of self-employment. Some said they would need more guidance on the application form to allocate items appropriately. For example, one man was a minicab driver and did not understand whether the term 'stock' applied to him. He did not buy goods, but did have receipts for purchases (of fuel). Others raised questions in the interviews as to the exact meaning of 'business costs', 'expenses', and 'tax', and there was widespread uncertainty as to what 'regular' meant in this context.

As mentioned in Chapter 3, for some people the language used in the reporting tool did not match the language they used in the day-to-day running of their businesses. In particular, it was normal for some people to take a 'wage' or regular drawings from their business. These people queried what figures they would therefore be required to enter as 'income'.

The list in the box below comprises more specific questions raised about allowable expenses and gives an indication of the level of detailed support and guidance that some people will require if the reporting arrangements are to work smoothly for both claimants and DWP.

### Specific questions raised about information requirements

- How the cost of replacing stock or tools lost to theft, damage or vandalism would be dealt with?
- Which components of vehicle upkeep and property maintenance would be allowed, and how would this be allocated to monthly cash flow?
- How would professional fees, accreditation fees, and licences (some of which become due at the same time of year) be dealt with?
- How would 'wear and tear' on homes be assessed?
- How would the assessment deal with materials bought but billed directly to customers?
- Would subsistence expenses (for example, food purchased while out working) be allowed?

If these sorts of questions could be answered most people felt they would be able to comply with the information requirements eventually once they were used to monthly reporting. Only one person had a strongly negative reaction to the reporting tool. This was the respondent referred to earlier who did not have good business records.

## 5.3 Potential for misreporting information

A consistent concern for the benefits system is the problem of fraud. Fraud is a highly sensitive issue but the opportunity was taken within the research interviews to explore respondents' views (where they had any) on the vulnerability of the Universal Credit reporting arrangements to fraud. Some people were happy to engage in a discussion about fraud. In some interviews it became clear that the respondent was not comfortable with this line of questioning as it carried the implication (for them) that they might be involved in fraudulent behaviour. Researchers used their judgment on the extent to which these questions were pursued.

From the limited data that it was possible to collect there are some useful findings that can help inform policy on fraud prevention. There was a general recognition that much of the information that might be asked for as part of a gateway interview could be falsified, but some more easily than others. Particularly easy to fabricate were thought to be diaries of appointments, cash books, marketing materials and business plans. Lists of customers and suppliers could also be falsified, but would be relatively easy to check. Evidence, such as proof of tax registration with HMRC and bank statements were thought to be more secure, but even these could be falsified.

Several people recognised that unannounced visits ('spot checks') to them while they were actually working would be strong evidence of genuine self-employment. It was also acknowledged that gathering supporting evidence from third parties, such as clients, customers or suppliers would similarly constitute strong evidence, but as noted earlier some respondents were clear that they would not want to breach their duty of confidentiality by supplying names and contact details for their clients to DWP.

## 5.4 Potential behavioural change in response to Universal Credit reporting requirements

As mentioned in Chapter 1, there has been an underlying policy intention that the requirements placed on self-employed people and businesses should be kept as simple as possible and compliance should not become a burden to the extent that people leave self-employment and return to claiming benefits.

The responses to the proposed monthly reporting requirements suggest that most people in the sample would be able to comply with little difficulty or adjustments to their normal business practices. Some others, however, felt they would have to make changes or adapt their current practices, but that in time they would become used to new ways of doing things. There were only two respondents who said that the additional work and hassle associated with monthly reporting might make them think about dropping their claim, but not stop their self-employment. Both were in the high income category.

Some respondents said that the proposed reporting arrangements would not be a problem for them or would require them to make changes in the way they ran their business that they considered beneficial, such as keeping more accurate and systematic records or keeping up with their finances more regularly.

## 5.5 Discussion

This chapter has explored the responses of the study group of self-employed people to the evidence requirements that are proposed for Universal Credit and which were set out in the DWP memorandum on the draft regulations. In particular, respondents were asked about their ability to comply with the requirements of the gateway interview and the monthly reporting arrangements.

The general conclusion that can be drawn is that most of the people in this study group would be able to meet evidence and reporting requirements, at least in the medium term, after getting used to the new requirements. There were, however, some people who foresaw difficulties and policy makers will need to consider whether some form of assistance should be made available to them to help them meet the Universal Credit reporting requirements.

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 business and the way in which monies came into and out of the business. Nevertheless, the list of permissible evidence discussed with respondents suggests that it will be sufficient to allow most claimants to demonstrate genuine, gainful self-employment. However, policy makers could consider expanding the list to include respondents' suggestions for alternative or additional forms of evidence (such as websites or physical evidence of goods produced).

The seven-day reporting period was generally thought to be feasible, but respondents also felt that there could be some flexibility around the seven-day target to ensure that people were not penalised when there were reasonable grounds for late reporting (such as planned time away or contingencies like periods of sickness).

The online reporting tool was received positively by most respondents though there were a number of questions about the meaning and definition of various terms, such as 'stock', 'business costs' and 'expenses'. Policy makers could consider how best to ensure that these terms are accurately understood in order to prevent misreporting.

It was noteworthy that 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.

# 6 The Minimum Income Floor

## Chapter summary

- 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.
- Because a claimant's Minimum Income Floor will only be set following an assessment by the Department for Work and Pensions (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.
- 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 to be sufficient. For businesses needing to develop a client base, build resources or develop demand for goods it was felt more time would be needed.

As mentioned in Chapter 1, one policy aim of Universal Credit is to encourage people to work full time unless they are in circumstances that might restrict their working capacity in some way (such as childcare or other caring responsibilities, or limiting health conditions). A principal policy lever for achieving this aim for self-employed people is the use of a 'Minimum Income Floor' in the assessment of income.

Section 6.1 begins the chapter with an explanation of the Minimum Income Floor that will apply to self-employed claimants of Universal Credit and the exemptions that some will be allowed in the first year of their claim (known as the ‘start-up period’). We then explore how people in the study group understood the principles of the Minimum Income Floor (in Section 6.2), how they thought it might affect them (Section 6.3), and how they might respond as a result (Section 6.4). Section 6.5 looks at the possible effects on businesses that have been low earning over a long period or where people might be considered ‘underemployed’. In Section 6.6 we present an analysis of the study group’s views on the proposed start-up period.

## 6.1 Principles of the Minimum Income Floor and start-up period

A self-employed claimant’s award of Universal Credit will be based on the balance of their monthly income (on a ‘cash in’ basis) and their monthly outgoings (on a ‘cash out’ basis). However, every self-employed claimant in the All Work Related Requirements Group will also have a ‘Minimum Income Floor’ set for their claim. The Minimum Income Floor for any individual will be based on the maximum number of hours per week that it is deemed reasonable for them to work taking into account their health and their caring responsibilities. If the claimant’s net income falls below the prescribed amount of the ‘Minimum Income Floor’ then income will be deemed to be at the level of the floor for the purposes of calculating Universal Credit. The effect will be to create a maximum amount of Universal Credit that can be received that will not rise in response to any further fall in income. Hence, for claimants whose net income falls below the floor in any one month, their Universal Credit for the next month will be paid at this maximum amount and not fully reflect the previous month’s actual income.

Recognising that new businesses take some time to become established the draft regulations made provision for the Minimum Income Floor conditions not to be applied for the first 12 months of a new self-employed Universal Credit claim. During this start-up period claimants will be required to attend additional interviews every three months to ensure that they still meet the requirements of being in gainful employment.

At the time the research was carried out (September/October 2012) DWP were developing the details around the Minimum Income Floor. It was not possible therefore to discuss with the people in the study group exactly how the floor would affect them and in particular how their income would be affected. Importantly, it was not possible for the interviewers to know the number of hours per week that would be used in the calculation of the Minimum Income Floor for individual respondents. This was a particular limitation among respondents who described health limitations and/or caring responsibilities. Hence in the interviews it was only possible to explore respondents’ views about how they **might** be affected and how they **might** respond (that is, the possible behavioural effects of the policy).

As a means of exploring the possible effects of the Minimum Income Floor respondents were asked to reflect on the likely impact of a £220 a week Floor and a £110 a week Floor. The first of these figures is an approximation of what the Minimum Income Floor would be for a full-time worker (around 35 hours a week) on the national minimum wage (just over £6 an hour at the time of the interviews). The second figure is an approximation for someone working 18 hours a week (that is, the proposed number of hours at which a person would be deemed to have self-employment as their main occupation if they had no caring responsibilities or health conditions). Respondents were also asked if they would be able to increase their hours of work or increase their income in some other way.

### 6.2 Understanding the principles of the Minimum Income Floor

Prior to the research interviews respondents had received an information sheet with the letter of invitation which summarised the principles of the Minimum Income Floor. Some respondents appeared to grasp these fairly easily and quickly, including the policy intention of not providing long-term support for failing businesses. Some people had accessed the DWP memorandum on the Universal Credit draft regulations where this policy intent is clearer. Other respondents were less clear or struggled in their understanding initially, but said they grasped the principles better after an explanation from the researcher. A small number of respondents appeared not to understand how the Floor would operate and affect them and tended to come to somewhat simplistic (and largely negative) views about it.

One impact of the Minimum Income Floor was clear to most respondents, however, that is, they understood that if their income from self-employment fell below the Floor their overall income would be affected. Beyond this general understanding there was less understanding of how and when income would actually be changed.

Some people grasped that if their income from self-employment fell below the Floor then Universal Credit would not fully reflect this drop in income. Others thought that Universal Credit would decrease at the same time as their self-employed income fell. Although it was sometimes clearer to the respondent after further discussion with the interviewer that Universal Credit would not reduce in this way, people's initial understanding was a misperception. A common view, particularly among the people in the sample with lower incomes, was that the Minimum Income Floor was unfair and punitive, and would make it harder for them to meet living expenses at times when their businesses might be experiencing a dip.

### 6.3 Possible effects of the Minimum Income Floor on study group participants

As mentioned above discussions about the possible effect of the Minimum Income Floor on respondents were limited by the lack of detailed regulations at the time of the research interviews. In particular it was not known how caring responsibilities (for children and others) or health conditions might be treated in assessing the hours per week that Universal Credit recipients would be expected to work.

However, from the information provided by the respondents it was possible to identify different groups of claimants who would probably have different Minimum Income Floors applied to them depending on their personal circumstances. These groups were people who had:

- No health-related restrictions and no caring responsibilities.
- Caring responsibilities for children.
- Caring responsibilities for adult family members.
- Health conditions and disabilities that limited work capability.
- A mix of caring responsibilities and health conditions.

It is perhaps not surprising to find these different types within the study group; such diversity is to be expected. Nevertheless, because any developments in policy will need to take account of how the Minimum Income Floor will impact on people with various health conditions and caring responsibilities, it is useful to identify these different types of claimant and explore how they think might be affected by the Floor.

### 6.3.1 No health-related restrictions and no caring responsibilities

It is likely that these people would have a Minimum Income Floor based on full-time hours at the national minimum wage (that is, close to the £220 figure raised in the interviews). There were 10 respondents in the sample who appeared to fit within this group. Some were in their first year of trading and so would not have been subject to the Minimum Income Floor if it applied now. Most of these were working around the 16-hours threshold or below and said that their self-employed income consistently or occasionally fell below a level of £220 a week.

Of the people in the study group who were in more established businesses (that is, they had been receiving tax credits for over two years), only one said that they consistently earned over £220 a week and would therefore not expect to be affected by the Minimum Income Floor. The rest reported that they experienced fluctuations in their 'cash in' income and would expect to earn less than £220 a week in some months. In an extreme example, one respondent explained that his income came in large one off payments at the end of substantial amounts of time working on individual projects. His monthly income was mostly zero therefore with the occasional single payment of thousands of pounds. Some people had worked in low paid self-employment for several years and said that they almost always earned less than £220 a week (because for example there was always a low level of demand for the goods they produced) and would therefore consistently fall below the Minimum Income Floor.

### 6.3.2 Caring responsibilities for children

This group comprised over half of the study group and included lone parents with sole responsibility for their children and couples who had a variety of caring arrangements. Some respondents, for example, had partners who they described as caring full-time for their children, while others described domestic arrangements under which childcare was shared in some way. The ages of children ranged from babies of several months to teenagers 18-years-old (and older).

The lone parents form an interesting group. All had only school age children rather than very young children. Most worked around 16 hours a week, which would allow them to receive around the maximum possible level of tax credits and fit their work around school hours. The two lone parents who worked in excess of 17½ hours carried out their business from home.

Self-employment can clearly be an attractive way in which lone parents can combine working and childcare. Under Universal Credit it is likely that the lone parents in this sample working around 16 hours a week will be subject to a Minimum Income Floor around the level of £110 that was raised in the research interviews. In response to the question about how such a Floor might affect them, most thought they would not be adversely affected. One, determined not to be penalised, hoped that by the time new arrangements were implemented she would be able to reach earnings of £110. However, some with fluctuating earnings thought they might drop below £110 a week in some months, and two thought they would fall consistently below. These two lone parents who thought that they might fall below a Minimum Income Floor of around £110 a week both worked for employers though they were technically self-employed. They felt they had no control over their hours as they were working what their employer dictated.

As mentioned above, the couples with children had varying arrangements for childcare. The relevance for policy here is how people's childcare arrangements should be reflected in conditionality requirements and the Minimum Income Floor. In some households there was a clear main carer, usually but not always the partner of the respondent. However, in a number of other households caring arrangements were more complex, but generally characterised by sharing the care and in one case using help from the respondent's own carer (that is, not a paid childminder). No respondents reported using paid childcare. Parents explained that good quality childcare was

not available to them, or too expensive, and a view frequently expressed was that they wanted to care for their own children. This was often thought to be particularly important if children had had previous negative experiences, such as family disruption or trauma, or had only one parent. Providing care from within a household was often made possible by the respondent working from home or living above work premises (in the case of shops and restaurants).

The respondents in couples were a heterogeneous group including those who worked below, around and over 16-17½ hours a week, and those who were high, medium or low earners. Hence, it was not surprising that there were a range of responses to the questions about the likely impact of either a £220 or £110 Minimum Income Floor. Some people reported that their pattern of fluctuating or unpredictable earnings meant that they would sometimes (and perhaps often) fall below the £220 level though most were more confident of consistently earning over £110 a week.

These findings suggest that there is a question for policy to address about whether people's choices about childcare arrangements should be reflected in their conditionality requirements and the Minimum Income Floor that should apply to them and we discuss this further in Chapter 7.

### 6.3.3 Caring responsibilities for adult family members

A small number of people in the study group provided some form of care for family members (for disabled partners or a sick relative). One disabled partner received Disability Living Allowance and the other received the disability premium within her own tax credit award.

All thought they would be adversely affected by a Minimum Income Floor of £220. Some experienced peaks and troughs in their incomes that were fairly predictable as demands for their services varied over the course of a year. They could say with some certainty that they would not earn £220 a week during the leaner parts of the year. Others had less predictable demand for their services (they did not have regular clienteles), but had experienced poor weeks in the past when they would not have earned £220. All were more confident that they would clear £110 in most weeks, though admitted the possibility that they might not if demand was particularly low.

In discussing the *Conditionality Earnings Threshold* for Universal Credit claimants the memorandum on the draft regulations explains that this will depend on:

*'... establishing the number of hours the claimant can reasonably be expected to work (maximum of 35 hours but adapted according to individual's circumstances, for example, to take into account caring responsibilities or a physical or mental condition).'*

(para.225)

Whether or not the group of claimants in the sample providing care for family members would have the Minimum Income Floor applied to them in practice would depend on how caring responsibilities are taken into account for the calculation of the Conditionality Earnings Threshold. At the time of writing these details are not known. As the memorandum on the draft regulations explains:

*'In setting the final design of the MIF, we will carefully consider these tailored easements'*

(para.168).

### 6.3.4 Health conditions and disabilities that limited work capability

As already mentioned in Chapters 2 and 3 some people adapted their working patterns to suit health conditions or disabilities. In this sample around a quarter of respondents reported health conditions that had some bearing on their self-employed work, although only one (a Disability Living Allowance recipient) received a health-related social security benefit. Some reported mental health conditions while the rest had a variety of musculo-skeletal, circulatory and neurological conditions that caused physical limitations.

Most had been in self-employment for over two years and had established fairly regular working patterns for themselves that suited the limitations caused by their health, though some experienced variations in their incomes due to the nature of their self-employment (such as shop keeping and taxi driving). Only one person in the sample (working in a professional occupation) was confident that their income would regularly be above £220 a week, although most thought that earning £110 a week was mostly guaranteed. The rest fell into two broad groupings: those who thought they would be vulnerable to dipping below £220 because of variations in earnings due to seasonal effects or when health problems worsened, and those who said they ‘always’ earned less than £220.

It should be emphasised that people in this study group are not representative of the self-employed tax credit population. However, there does appear to be a picture emerging of a particular group of claimants who have limiting health problems, but who, nevertheless, have established patterns of working combined with receipt of tax credits that are financially viable for them.

As mentioned above, the policy intention is to refine the requirements of the Conditionality Earnings Threshold to take account of health limitations. Hence, it is not clear how the people we spoke to would be affected and how the Minimum Income Floor might be applied to them. What does seem clear, however, is that most people in this group had not had any formal health assessment (such as a Work Capability Assessment) for the purposes of claiming benefits.

### **6.3.5 A mix of caring responsibilities and personal health conditions**

A small number of people in the study group had both personal health conditions and childcare responsibilities that limited the number of hours they worked. Both worked from home. Both reported that their earnings were low and mostly below the £110 a week level and certainly always below £220 and felt that they would be adversely affected by a Minimum Income Floor set at either of those two levels.

However, as noted above, the expectation is that further regulations or guidance will make allowances for people in circumstances like these and that if a Minimum Income Floor were to apply in practice it might be relatively low.

## **6.4 Perceived behavioural effects of earnings falling below the Minimum Income Floor**

Part of the intent of introducing the Minimum Income Floor is to effect a change in the behaviour of Universal Credit claimants, that is, to encourage them to increase their income (possibly, though not necessarily, through increasing the hours they work). We were not able to indicate to each respondent how the Minimum Income Floor would affect them personally as the detail of policy had yet to be finalised. Hence, in the research interviews we asked all respondents about their capacity to increase their hours or earnings, although it was apparent that for some there was likely to be no pressure to do so in practice (because they were likely to have earnings above the floor, or health conditions or caring responsibilities which would exempt them from the floor). The question was couched in terms of how people might respond if they experienced a drop in income (of around £50 a week by way of illustration) as a result of earnings falling below the Minimum Income Floor.

The responses give a useful insight into the way that people are motivated differently to increase their income and how the nature and labour market context of their self-employment allow or restrict the opportunities available to them to do so. Responses fell into four broad groupings:

- Respondents who said they would cope with reduced income.
- Respondents who thought they would be able to change their behaviour in order to raise their income above the floor.

- A few respondents who considered that they might decide to give up their self-employment.
- A group of respondents who found it difficult to think how they might respond because of the limited opportunities to make any changes to their working arrangements.

Distinguishing the groups is useful for thinking through policy implications but, as we explain later, they are not necessarily mutually exclusive. It is also important to note that there was no direct correlation between the types of claimants identified in the previous section who were likely to be affected by the Minimum Income Floor in different ways and the behavioural responses they described. For example, people who had no health conditions and no caring responsibilities were neither more nor less likely to say they would change their behaviour if their income dipped beneath the Floor. Their responses were much more linked to the type of work they did, the control they had over workloads, and their patterns of income and outgoings.

### 6.4.1 Coping with a reduction in income

Some respondents who said that their pattern of income might mean that they occasionally dropped below the Minimum Income Floor thought that they would have to cope with the resultant temporary drop in income, for example by drawing on the support of family members or cutting back on purchases. People in the study group who were still developing their businesses were determined not to allow a temporary fall in income to damage their longer term ambitions.

### 6.4.2 Changing behaviour to raise income, while maintaining self-employment

Several respondents recognised that they did have possibilities for increasing their hours or income. Many said they were already trying to do so as their aims were to expand their businesses. Here, people were looking to increase the number of clients or customers they could attract, or increase the manufacture or sale of goods. Others, however, were not currently trying to increase hours or income as they had reached a balance in their lives (particularly in relation to limitations imposed by their health or caring responsibilities) that they were content to maintain.

Examples given of ways of changing behaviour included:

- Increasing the number of hours worked.
- Increasing numbers of clients/customers.
- Looking for additional (waged) work to supplement self-employment.
- Changing the balance of time spent between their portfolio of jobs.
- Increasing the number of hours of childcare used, in order to release time for more self-employed work.

As mentioned above, not all of these avenues were ones that people wanted to pursue, but they recognised them as possibilities should the need arise. For some, there was more reluctance to think about options, such as looking for additional, waged work because it was felt that such a move would reduce opportunities for developing their self-employment which was their real objective. One woman's self-employed work relied on maintaining a stable client base, but was struggling to reach a level of demand that produced a regular viable income. She thought the time she had available to her was better spent being ready to respond to ad hoc demand from clients or building up her business rather than looking for additional, different employment.

### 6.4.3 Giving up self-employment altogether

A small number of respondents thought that if they suffered a fall in income to the extent that meant they could not meet their daily living costs they would consider ending their self-employment, either to return to claiming out-of-work benefits or to look for paid employment. These people tended to be people who felt that their household budgeting was already tight and could not cope with a drop in income. They were not necessarily on a low income, but those in the low income group felt the most vulnerable. A common reaction also was that they felt they had little opportunity to increase their income or hours at present.

One respondent, a lone parent, combined home-based self-employment with looking after several children. She was very restricted in the number of hours she could devote to her job, and her business was being affected by the recession, in that the numbers of people using her on-line services had reduced drastically in the previous year or so. She felt that she could not cope with any further reduction in income and would likely give up her self-employment if that happened.

Another woman, a lone parent with school age children, worked regular hours as a cleaner for a single employer but on a self-employed basis. She was reluctant to increase her hours of work and in any case saw no possibility that her employer would want her to work more. If self-employed work became unsustainable she felt her only option would be ‘... to go on the dole ... and try and find something else ...’.

### 6.4.4 Limited opportunities to increase hours/income

Some respondents felt they had little opportunity to increase their hours. This group included people who also fell in the groups above. Though generally understanding and agreeing with the policy aim of encouraging claimants to increase earnings, this group of respondents gave a variety of reasons why this would be difficult in their current circumstances and in some cases undesirable for them personally. For some, not being able to increase hours would not be relevant under Universal Credit as they consistently earned over the £220 a week threshold.

Among those who felt they might be affected by the Minimum Income Floor were those who already worked full-time hours or more. Examples here were people working in retail or catering jobs, or taxi driving where income depended on the level of custom, a factor over which respondents said they had little control. These people felt they had little prospect of increasing either hours or income and some thought they might choose to give up self-employment if the impact of the Minimum Income Floor was severe for them. Others did not know what they would do in practice, but said they would probably not give up their self-employment; they would either cope with less money or carry on in the hope that their business improved.

Some people felt restricted in their capacity to increase their hours by their own health or caring commitments for children or other family members. For some, the constraints were described as effectively permanent and fixed, such as having to be available for children outside school hours, or having to take breaks from working in order not to create health problems for themselves. People working under agency arrangements or working for a single employer (though technically self-employed) felt particularly constrained because while they could ask for more hours they could not control what was required of them.

Not many respondents in the sample spontaneously raised the possibility of increasing income in ways other than by increasing hours. Some did recognise that income might be increased by raising the prices they charged for goods and services, but this was usually ruled out as an option because of the fear of losing clients or custom to rival businesses.

## 6.5 Underemployment, low earning businesses and the Minimum Income Floor

In this section we attempt to explore the likely effects of the Minimum Income Floor on people in long-term, low earning businesses and people currently ‘underemployed’, as these are two groups whom the Minimum Income Floor is meant to influence. We have found no definitions of these terms that enable us to identify with any certainty people in our study group who fit these categories. Hence, what we present here must be treated with some caution. Nevertheless, it is possible from people’s accounts to suggest that some claimants might be thought of in these ways and then to explore their situations and reactions to the idea of a Minimum Income Floor.

### 6.5.1 Long-term, low earnings

We first present findings about people in this study group who might be considered to fall within the category of long-term, low earners.

One person caring for several young school age children and managing a health condition had been able to do some low-skilled self-employed work for several years. Earnings were generally below £100 a week. If faced with the possibility of a drop in income due to the Minimum Income Floor this person thought it would not be possible to manage financially, and looking for work as an employee might be the alternative.

Several respondents who described long-term low earnings said there was a lack of demand for their goods or services. They had been working in retail or producing craft goods and relied on sales to generate their self-employed income. One person, a lone parent with a school age child, made and sold craft items and had done for many years. She had always found it hard to generate much of an income and had very variable earnings. If her self-employment became non-viable because of the Minimum Income Floor she thought that she might try to retrain in something new.

Two further examples raise the question of **when** low earnings become ‘long-term’ (and hence a cause of policy concern). Two people who took part had been making only a low income from their self-employment for the past two or three years, but prior to that had been making a higher (and sustainable) level of income. Both explained their recent low income as the result of the economic downturn (even though they were in very different lines of work). They thought it was possible to imagine their incomes rising again in the future, but not possible to say when. One had already taken on a waged job recently in response to the drop in self-employed income, and the other said he was willing to take on additional work if the opportunity arose, but thought the only way he could respond to a drop in income due to the Minimum Income Floor was to reduce family spending.

### 6.5.2 ‘Underemployed claimants’

The second group who are a target of the Minimum Income Floor provisions are those who are apparently not making efforts to increase their income from self-employment, but have a history of long-term receipt of relatively high levels of tax credits as a result of having low earnings and working few hours (referred to as ‘underemployment’ in the explanatory memorandum on the draft Universal Credit regulations (DWP 2012)).

In this study group there were people who explained that they were content with the balance of (self-employed) work and spending time with their family or following other pursuits that receipt of tax credits allowed them. They did have the capacity to work some more hours (that is, within their current caring and health constraints), but chose not to. One said he might increase his hours if income fell because of the Minimum Income Floor, but might also approach wider family members

for financial support during such times as an alternative to increasing the number of his working hours. Another respondent, with a partner who was employed full time, worked few hours and it was not clear whether the Minimum Income Floor provisions would apply under Universal Credit. If this did lead to a drop in income, one consideration for this person would be looking for paid employment.

## 6.6 The proposed 12-month start-up period

### 6.6.1 Views on not applying the Minimum Income Floor for 12 months

There was a general consensus among people in this study group that not applying the Minimum Income Floor for the first 12 months of self-employment was a good idea. Many were able to draw on personal experiences, either in new self-employment or more established businesses, of taking time to build up their work to a point when they were first breaking even and eventually making a profit. Some respondents, though supporting the idea in principle, said that they would not have benefited personally from such a start-up period because their self-employment was of a type that did not require a long time before becoming profitable. Examples here were people who already had established lists of clients or customers from previous employment whom they continued working with after becoming self-employed (such as hairdressers and nail technicians), people who worked for agencies or a single employer (in arrangements that are close to waged employment), and people for whom there was already a demand for their type of service that could be accessed fairly easily (such as gardeners or painters and decorators).

There was less consensus about whether 12 months was a sufficient period in which to expect businesses to become established. Some types of self-employment described by respondents required financial investment in order to pay for a number of necessary items, such as equipment, raw materials, or promotional materials. This meant that they could be showing net losses for a considerable length of time. Some people in the sample who had been in receipt of tax credits for two years or more referred to their own experiences of taking longer than 12 months to begin turning a reasonable profit. One respondent said it had taken her four years to reach the position she was in now of having a stable income from self-employment. At the time she started she thought it would take a year to become established, but actually made no money at all in the first nine months, during which time she said that the support from tax credits had been essential.

Other types of self-employment required the establishment of a customer base or a list of regular buyers (such as small-scale manufacturing and sales). Again, experiences were that this always takes time and possibly longer than 12 months. One respondent who was making and selling craft items and in the first year of trading projected that this work would not be generating an income as high as £220 a week (the Minimum Income Floor that might apply) until well into her second year.

The two main suggestions from respondents about changing the length of the start-up period were either to extend the period to two years, or to have a flexible period tailored to the type of self-employment being undertaken.

### 6.6.2 Additional interviews during the start-up period

There were mixed views among people in this study about the requirement that new Universal Credit claimants in the first year of trading should attend additional interviews every three months. Some were not particularly concerned and said that they would have been able to comply if they had been subject to such a requirement. Others were less happy. Some perceived that some interviews would serve no purpose for them, but would take up time that they could better devote to their businesses. Some with negative experiences of dealing with Jobcentre Plus in the past thought that such interviews would only be used as surveillance of their activities.

A further group of respondents took a measured view. They said they could see that additional interviews could be constructive if used as a means of identifying sources of support to help newly self-employed people develop their businesses. A general view was that any input from DWP that was genuinely supportive would be welcome while anything that was perceived as 'pressure' would not.

### 6.7 Discussion

In this chapter we have set out findings on the Minimum Income Floor and start-up period. What emerges is that there is likely to be a complex relationship between an individual's self-employment and the Minimum Income Floor that might apply to them. Fluctuation in earnings across a year is likely to mean that many claimants (in this study group, it was possibly the majority) will experience the effect of the Minimum Income Floor being applied.

Respondents' understanding of the principles of the Minimum Income Floor and how it might affect them was varied. Faced with the hypothetical prospect of having a lower overall income as a result of the Minimum Income Floor respondents (including those who could be identified as either 'underemployed' or in a 'long-term, low earning business') reacted in a range of ways, including the suggestion that they might end their self-employment.

There is clearly a need for Universal Credit claimants to understand how the Minimum Income Floor will affect them individually. This will be a task that will fall to a number of different organisations and their staff, including DWP, advice agencies and Work Programme providers. There is a need therefore to consider how such staff can become sufficiently knowledgeable and expert in order that accurate information is given to claimants and unintended effects are avoided (such as unnecessarily giving up self-employment).

The findings on the start-up period suggest that this will be a useful policy measure for Universal Credit claimants starting new self-employed ventures. Further consideration could be given to how long this period should be given that there is evidence from this research that some businesses can take longer than 12 months to establish themselves as 'financially self-sufficient'.

Findings on the additional interviews during the start-up period clearly show that self-employed Universal Credit claimants would not want to have extra pressure on them when they are trying to establish a business, but might welcome constructive support that would help them develop their business. There is a risk that the interviews 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 quarterly interviews will need to be trained to have a good understanding of self-employment in order for the interviews to be effective in this supportive role. There is clearly scope for developing the role of gateway interviewers to incorporate a business advice function. Policy makers might want to consider how far this possibility is feasible and/or desirable.

# 7 Conclusions, and policy and delivery implications

In this final chapter we bring together key findings and raise issues which this study suggests warrant further consideration as policy on Universal Credit continues to develop.

The study reported here was commissioned and conducted quickly in order to provide information required by the Department for Work and Pensions (DWP) to inform the implementation of arrangements for self-employed people who apply for Universal Credit. Specific requirements were to investigate the kinds of work undertaken by self-employed people within the scope of Universal Credit, and their patterns of activity and earnings. Policy makers wanted to know how such people might respond to the on-line reporting tool, which is an important part of the income assessment, and to the gateway interview, a new feature in Universal Credit. Information was needed in order to develop further the rules for the Minimum Income Floor, another completely new feature on which policy makers were still working when the research was commissioned.

The chapter opens with some reflections on the conduct of the study (in Section 7.1). We discuss how the need to produce findings as quickly as possible for DWP placed some limitations on the research design which need to be acknowledged. Nevertheless, we are confident that the findings from our group of self-employed people currently claiming tax credits and their perceptions of the impact on them of Universal Credit are an important contribution to policy development.

In Section 7.2 we explore some of the findings with significance for policy and delivery. Some of these findings bear directly on current proposals for the implementation of Universal Credit, including how information about the benefit might be communicated to the target population of existing and potential self-employed claimants, reporting requirements, gateway interviews, the Minimum Income Floor and the start-up period. In addition we discuss a number of other issues that might usefully inform future policy thinking about Universal Credit for self-employed people.

## 7.1 Reflections on the conduct of the study

The speed at which findings were required did set some limitations for the study, particularly in the selection of people to take part in research interviews, and in the kind of questions and discussion that was possible. This has been explained and addressed throughout the report and attention will be drawn again in this chapter where such issues are relevant.

There was no attempt in this small qualitative study to select a group of people that would be statistically representative of the low/middle income self-employed population who will come into scope for Universal Credit. Rather, a sample was drawn from Her Majesty's Revenue and Customs (HMRC) administrative data on tax credit recipients, which contained information about people's incomes and hours worked. The researchers recruited people who were interested to take part, building up a study group to include self-employed people from a broad range of household and employment circumstances.

This approach was largely successful. Those who took part were engaged in a range of self-employed activities and there were examples of all the main types of business organisation. There was a good mix of household types, people with and without children, and some people from minority ethnic groups. The lone parents included two grandmothers in their 50s who had sole formal responsibility for bringing up a child and there were also a number of people with relatively

large numbers of children. This perhaps reflects current patterns of family formation and dissolution as well as people's decisions about responsibilities and choices.

In addition to the discussion of who was included in our study group, we must also think of who was not. Some occupation groups, which include relatively low numbers of people, but high proportions of self-employed people, such as farming and fishing, were not represented at all. Previous research (Boden and Corden 1994) has shown that particular issues arose for these occupation groups in the assessment of income for purposes of income-related benefits and tax credits. Policy will need to take account of the implications of a move to monthly cash flow accounting for farming and fishing and other atypical occupations.

Although most of the main kinds of business organisation were represented in the study group, most of the respondents were sole traders. There were few examples of business partnerships and none of non-spouse partnerships. Professional accountants are familiar with ways in which earnings may be formally attributed in partnerships to maximise individual financial situations. The Universal Credit income assessment will be based on the household so spouse partnerships may not prove problematic. Issues may arise, however, in formal attribution of contributions to business activity and earnings in two generational partnerships and in non-relational partnerships. Numbers of such people are likely to be small in the overall Universal Credit population. Nevertheless, previous evidence from a range of income assessments of self-employed people (see, for example, Boden and Corden 1998) was that a relatively small number of such cases raised complex issues. Policy makers may want to avoid, or be prepared for similar issues arising with Universal Credit. Consultation with and advice from the professional accountancy associations would be valuable here.

### 7.2 Policy and delivery implications

As mentioned in Chapter 1, policy on Universal Credit is still in development within the broad parameters of the Welfare Reform Act 2012 and the Universal Credit regulations. In this section we draw out some implications from the study's findings which policy makers may wish to consider, including on how the principles and operational details of Universal Credit are communicated to existing tax credit recipients and potential Universal Credit claimants, on the gateway interview, monthly reporting requirements and the Minimum Income Floor.

A key finding from this study however is that there is enormous diversity in the self-employed population: in what people do and when they do it, how their business is organised, how their incomes and outgoings vary, how they maintain their business records and accounting arrangements, and in their basic skills of language and numeracy. All this is to be expected but the diversity uncovered in even a small scale study such as this (with 45 respondents) reinforces the message that for Universal Credit to achieve its policy aims it will need to accommodate such diversity (in both its substance and its accompanying administrative arrangements) and not lead to unintended or undesirable effects.

This section is not intended as a prescriptive list of recommendations. Rather, it is intended to provide indications to policy makers and other interested parties of where further thinking would be useful in order to ensure that the substance and delivery of Universal Credit matches policy aspirations.

## 7.2.1 Communications

### *Reporting requirements*

Complying with the reporting requirements of Universal Credit places new demands on self-employed claimants. While the gateway interviews and monthly reporting were relatively easily understood by most people in the study it will nevertheless be important that people understand what information they will be required to produce at the gateway and quarterly interviews and in monthly reporting of income and outgoings.

As explained in Chapter 3 many respondents needed prompting to think about what constituted 'work' for them in the conduct of their self-employed business. Among the people in our study, group boundaries between 'work' activities and 'non-work' activities were not always recognised immediately by the people concerned. It may be useful therefore to have prompts and suggestions in application forms and during gateway interviews to enable people to describe all the activities that go into their work.

As mentioned in Chapter 5 although there were concerns expressed and difficulties raised about the reporting requirements under Universal Credit, no respondents suggested that they might close down their self-employed business as a result of these new demands on them. Clear explanations in guidance (to filling in the online reporting forms) and possibly some sort of initial training (plus ongoing support) for claimants who needed it would go some way to avoiding negative outcomes (such as incorrect or late reporting that might lead to a delay or reduction in Universal Credit payments).

### *Minimum income floor*

While the gateway interviews and monthly reporting were not difficult to grasp for respondents the same cannot be said for the Minimum Income Floor. Here there are a number of issues that could be addressed in the way DWP communicates the principles and effects of the Floor. We should be clear here that the amount of information that the researchers were able to give to the respondents was limited and sometimes insufficient for some people to get a clear idea about how they would be affected. In particular it was not possible to know what the Floor would be for individuals with health conditions or caring responsibilities. Perhaps because of this lack of clarity a common reaction from respondents to discussion in the interview about the Minimum Income Floor was one of concern, although in practice they might have been subject to a very low Floor or exempt altogether.

The most common cause of concern for respondents was the prospect that overall income would be negatively affected by the Floor at the same time as they would be experiencing a drop in self-employed income. As mentioned in Chapter 6 this struck some respondents as punitive and unfair. While there is a clear rationale for the Minimum Income Floor, as explained in the explanatory memorandum on the draft Universal Credit regulations, there is a challenge in presenting the Minimum Income Floor in a positive light to potential Universal Credit claimants.

Another reason for the negative responses to the Minimum Income Floor was an apparent lack of understanding about how it will impact on people's incomes. As explained in Chapter 6 it seemed that some people did not recognise that when their self-employed income for any month fell below the Minimum Income Floor then their award of Universal Credit would not fall at the same time, but it would be paid at a constant amount regardless of how far below the Floor their income reached. What people tended to focus on was that their overall income (from earnings and Universal Credit) would fall as their self-employed income fell.

It is likely that benefit claimants who are contemplating or being encouraged to consider self-employment as a route out of unemployment will want to know what Minimum Income Floor they will be subject to. Some thought needs to be given therefore about the information given to potential Universal Credit claimants about how health and caring responsibilities will be translated into expectations about how many hours they will be expected to work/aspire to. The gateway interviews might provide one opportunity for doing this. It is also important to note that DWP advisers or advisers in Work Programme provider organisations (and their supply chains) may be the principal channel through which benefit claimants first hear about and discuss the possibilities of self-employment. Some thought needs to be given therefore to how such advisers will be able to acquire the necessary knowledge and expertise of Universal Credit that will be needed to inform those discussions.

### *Cash accounting*

Findings suggest the importance of providing claimants with clear explanation of the reasons for using an income measure based on cash flow accounting. Several people who took part in this research said it was only possible to get a good idea of how much they were earning by taking the overall picture from a long base period. Gateway interviewers should be well equipped for explaining the reasons for the cash flow approach, and some misunderstandings and challenge should be expected from both new claimants, and those who are migrated from tax credits onto Universal Credit, as well as their professional advisers.

### *English as a second language*

We note also that this small study group did include a person who said their English language skills made it hard for them to understand requirements for reporting earnings for tax credits. This finding provides additional support for the suggestion from other recent research with tax credits recipients (Hall *et al.* 2012) that people who speak English as a second language may well need some additional support in communications about Universal Credit.

## **7.2.2 Gateway interviews**

The purpose of the gateway interviews is primarily to ascertain whether self-employed Universal Credit claimants are in gainful self-employment (as explained in Chapter 1). To carry out these interviews successfully Universal Credit staff will need to acquire new areas of knowledge and be given guidance on how to interpret and make judgments about types of evidence that will also be new to them. The gateway interview will be an important opportunity (and sometimes the only opportunity) to explain Universal Credit to new claimants, including the regime of monthly reporting of income and outgoings, conditionality requirements and the Minimum Income Floor.

The findings from this study suggest that complying with the gateway requirements will be possible without too much difficulty for most claimants, but some will perhaps struggle to produce more than one or two pieces of evidence. Consideration could therefore be given to adding other types of evidence that would be considered as valid (such as websites or physical proof of goods produced) or, if appropriate, making spot checks on self-employed people.

As we saw in Chapter 2, about a quarter of the study group reported a health condition that had some impact on their capacity to work. Self-employment does provide one way in which some people with health conditions can participate in paid work. It will be important that the conditionality regime of Universal Credit takes full account of this, and that gateway interviewers have training and experience to understand how disability, chronic ill health and fluctuating conditions affect how people can work. Of interest here is the finding that few of those people

who reported a limiting health condition were claiming a disability-related benefit. This suggests that receipt of a disability-related benefit will not be a sufficient indicator for use as a determinant in conditionality or deciding the Minimum Income Floor. Self-employed people are entitled to support through the Access to Work scheme. There was little evidence in this study group of use of this scheme. One suggestion from the findings is that promotion of Access to Work through implementation of Universal Credit might enable disabled people to increase earnings capacity.

### **7.2.3 Monthly reporting**

As mentioned in Chapter 2, members of many households combined self-employment and work as an employee, sometimes in a number of jobs. The implication here is that assessment of overall household income, on a monthly basis, is likely to mean, in some households, provision of/administrative collation of three or four separate sets of evidence from different kinds of self-employment and different employers. Such complexity may well increase the possibilities of error and delay.

Findings also suggest that supplying information every month for the purpose of calculating the following month's Universal Credit payment would be feasible for many claimants. However, there is a need to provide clearer and fuller explanation of how claimants should interpret what might be thought of as already well-understood terms, such as 'business costs', 'expenses' and 'tax'. There is an opportunity in the gateway interview to make sure that reporting requirements are fully understood, but there may also be a need for ongoing support to some claimants who are unsure about how to report their finances. As discussed in Chapter 5 some claimants might have particular difficulties because of language or health conditions affecting cognitive abilities and might need additional support in meeting the monthly reporting requirements. Consideration also needs to be given to how self-employed claimants with no access to computer facilities will be able to make claims and comply with the monthly reporting requirements.

Although the seven-day reporting deadline for monthly reporting was thought to be feasible for most respondents in this study there were some strong arguments that there should be some flexibility around this to accommodate, for example, people's holidays and periods of sickness.

The behavioural effects of the proposed information requirements for Universal Credit were explored with our study group, but it was not possible to explore with a group of potential self-employed people how they would respond to the prospect of having to provide monthly income and outgoings figures. If there is likely to be a disincentive effect in the future on people contemplating self-employment we would not be able to detect it directly in this research. In this study though there was no indication that people would be discouraged by the reporting requirements to the extent that they would cease their self-employed work.

### **7.2.4 Minimum Income Floor and start-up period**

We have already discussed above the challenges in communicating information about the Minimum Income Floor to potential Universal Credit claimants in the future. Here we consider some other issues that the Minimum Income Floor raises.

As mentioned above, most people in the study group who reported having health conditions had not had any formal health assessment (such as a Work Capability Assessment) for the purposes of claiming benefits. The question arises therefore of how the number of hours to be used in the calculation of an individual's Minimum Income Floor is to be assessed. There will be a need for guidance for claimants and for staff.

As mentioned in Chapter 6, some businesses are likely to take longer than 12 months to establish themselves as 'financially self-sufficient'. Policy therefore needs to consider whether and how it might continue to support such businesses, for example by extending the 12-month period for all new claimants or by taking a personalised, case-by-case approach and allowing advisers some flexibility in the 12-month limit.

Chapter 1 mentioned that the original proposal to allow claimants only one start-up period in a lifetime had been amended so that a further start-up period would be permissible after five years. It is not known how many people might be affected by this change in rules, but there were certainly people in our study group who were on their second or third attempt at self-employment. One question that could therefore be explored in evaluations of Universal Credit in the future is the effect on people's willingness to try further attempts at self-employment (within five years of a failed attempt) if they are subject to the Minimum Income Floor rules without the benefit of another start-up period.

As mentioned in Chapter 6, self-employed Universal Credit claimants would not want to have extra pressure on them when they are trying to establish a business, but might welcome constructive support that would help them develop their business. This has implications for how new claimants are treated within the 12-month start-up period. If the additional, quarterly interviews are to be used in the way preferred by the participants in this study then consideration needs to be given to the question of how such support can be delivered in Universal Credit. There is an opportunity here to develop additional interviews to be more of a carrot than a stick.

### **7.2.5 Language**

It is useful to reflect on the language used by self-employed people to describe monies coming in. It will be important that the language used on application forms for Universal Credit and in discussions in gateway interviews enable self-employed people to record appropriately and explain fully their incomes. As found in previous research with low-income self-employed people, terms such as 'takings' and 'turnover' are often used, for example by taxi-drivers and people running high street businesses. In this study group, shopkeepers spoke about 'drawings', the amount their accountant told them they could draw from their business for personal use each month. The levels of drawings recommended depend on computation of annual profit, and trading histories. Such people often do not themselves keep track of in-coming monies.

During the research interviews, the issue sometimes arose of the difference between 'earnings' and 'income' from self-employment. The Universal Credit regulations use the term 'income' to describe in-coming cash, and 'earnings' to describe the balance of cash in minus cash out. People taking part in the interviews did not always make these clear distinctions in the way they generally talked. We note also that in the draft on-line cash flow enquiry there is some conflation of these terms in the same question. Our findings lead us to conclude that terms should be used consistently in the promotion of Universal Credit and in all communications to self-employed claimants, and also in gateway interviews, to enable people to explain their circumstances appropriately, and to avoid error.

## **7.3 Final thoughts**

Universal Credit has a number of policy intentions. It has elements (in the more generous taper rate and the start-up period during which the Minimum Income Floor does not apply) that are aimed at supporting people to become established in new self-employment enterprises as a route out of unemployment and eventually off benefits. It also has features designed to reduce (or eliminate) the number of businesses that can be categorised as 'long-term, low earning' and to tackle the 'underemployment' of people who could reasonably be expected to be working or earning more than at present (in the conditionality and Minimum Income Floor rules).

The research presented in this report has generated new data on how self-employed people organise their business and personal lives that will enable policy makers to understand better how the policy and delivery of Universal Credit might affect the self-employed claimants of the future. There are also areas where further policy thinking might be useful and scope within the period leading up to full implementation of Universal Credit in October 2013 to improve knowledge and understanding about the new benefit.

Future evaluations of Universal Credit should ideally include specific components to explore its impact on self-employed claimants. It will be important to learn whether it is having the desired effect of encouraging and supporting people in self-employed work to the extent that they thrive and become self-sufficient or whether it is a barrier to self-employment or a cause of problems that hinder potentially viable and successful businesses.

# Appendix A

## Extract from Universal Credit Regulations 2012

### Gainful self-employment

#### Minimum income floor

**62.**—(1) Where, in any assessment period, a claimant is in gainful self-employment (see regulation 64) and the claimant’s earned income in respect of that assessment period is less than the minimum income floor, the claimant is to be treated as having earned income equal to the minimum income floor.

(2) The “minimum income floor” is, subject to paragraph (3)—

(a) the amount of the claimant’s individual threshold (see regulation 90(2)(b)) multiplied by 52 and divided by 12; minus

(b) an amount that the Secretary of State considers appropriate to take account of any income tax or national insurance contributions for which the person would be liable in respect of the assessment period if they had earned income of that amount.

(3) But if the claimant is a member of a couple and, by virtue of paragraph (1), the amount of the couple’s earned income would exceed the maximum for a couple—

(a) in a case where the couple’s combined earned income (before the application of paragraph (1)) is equal to or exceeds the maximum for a couple, paragraph (1) does not apply; and

(b) in any other case, the minimum income floor is to be reduced so that the amount of the couple’s earned income does not exceed the maximum for a couple.

(4) In paragraph (3) the “maximum for a couple” is—

(a) the amount applicable in regulation 90(3) (earnings threshold for a couple) multiplied by 52 and divided by 12; minus

(b) an amount that the Secretary of State considers appropriate to take account of any income tax or national insurance contributions for which the couple would be liable in respect of the assessment period if they had earned income of that amount.

(5) Paragraph (1) does not apply where—

(a) the assessment period falls within a start-up period or is the assessment period in which a start-up period begins or ends; or

(b) the claimant falls within any of the following sections of the Act—

(i) section 19 (claimants subject to no work-related requirements), except by virtue of regulation 90,

- (ii) section 20 (claimants subject to a work focused interview requirement only), or
- (iii) section 21 (claimants subject to a work preparation requirement only).

### **Start-up period**

**63.**—(1) A “start-up period” is a period of 12 months and applies from the beginning of the assessment period in which the Secretary of State determines that a claimant is in gainful self-employment where—

- (a) the claimant has begun to carry on the trade, profession or vocation which is their main employment in the 12 months preceding the beginning of that assessment period; and
- (b) the claimant is taking active steps to increase their earnings from that employment to the level of the claimant’s individual threshold (see regulation 90).

(2) But no start-up period may apply in relation to a claimant where a start-up period has previously applied in relation to that claimant, whether in relation to the current award or any previous award of universal credit, unless that previous start-up period—

- (a) began more than 5 years before the beginning of assessment period referred to in paragraph (1); and
- (b) applied in relation to a different trade, profession or vocation which the claimant has ceased to carry on.

(3) The Secretary of State may terminate a start-up period at any time if the person is no longer in gainful self-employment or is no longer taking the steps referred to in paragraph (1)(b).

### **Meaning of “gainful self-employment”**

**64.**—(1) A claimant is in gainful self-employment for the purposes of regulations 62 and 63 where the Secretary of State has determined that—

- (a) the claimant is carrying on a trade, profession or vocation as their main employment;
- (b) their earnings from that trade, profession or vocation are self-employed earnings; and
- (c) the trade, profession or vocation is organised, developed, regular and carried on in expectation of profit.

# Appendix B

## Topic Guide

### Self-employment and Universal Credit

The aims of the interview are to:

- Learn about your self-employment.
- Explore how the new benefit Universal Credit might affect you, compared with the current system of tax credits.

- Introduce self and the study.
- Remind respondent that he/she was selected because they currently get tax credits and are self-employed.
- Explain a payment of £30 is given for the interview. This is a gift and does not affect benefits or tax.
- Explain this interview will focus on:
  - some background information about themselves;
  - information about their current self-employment and any other work they do;
  - recent experiences of claiming tax credits;
  - how Universal Credit might affect them in the future.
- This will help DWP understand the implications of Universal Credit for self-employed people and inform the future development of the benefit.
- Stress independence of evaluation from DWP.
- Explain about confidentiality and anonymity. If respondent happy, ask them to sign consent form. Explain about recording and length of discussion – seek permission.

#### A. Background and Personal Circumstances

**A1 First of all, may I ask about yourself**, who is in your household?

- Probe for partner; children (ages); others.

**A2 How long have you lived here/at your current address?**

- Probe: is this owner occupation/private rent/social housing?
  - Probe for owner occupiers: ongoing or paid up mortgage?
- Is this accommodation part of self-employed work? e.g. home-worker, child minder, farm

**A3 May I ask about your health and any caring responsibilities? Does anybody in your household have a health condition which affects employment or responsibilities for care (including yourself, your partner, others in household)?**

- Probe about the effects (constraints on type/amount of work).

**A4 What are the main sources of income for the household?**

*Ask how important each source is:*

- self-employed earnings (from self, partner, others);
- employee earnings (from self, partner, others);
- tax credits – which?
- benefits – which?
- pensions?
- other – rentals, investments;
- Ask for estimate of total annual household income:
  - Up to £5,000;
  - £5,000–£11,000;
  - £11,000–£22,000;
  - £22,000–£30,000;
  - Over £30,000.

**A5 Can you tell me what level of personal capital or savings you have at the moment?**

**B. Current self-employment and other work**

**Thank you for putting me in the picture about your household. Now can we talk about your work?**

**B1 What is your self-employed work?**

Probe:

- occupation – what does this involve doing (main activities);
- scope of business – sole trader, business partnership (domestic partner and others), franchise, agency worker, share fisherman;
- premises, employees, assets – land, boats, vehicles, tools/equipment.

**B2 How long have you been doing this?**

**B3 What led you to be self-employed in this kind of work?**

- Route to this type of occupation.
- Route to self-employment (rather than work as an employee).
- How did business build up in early years:
  - Role of tax credits in supporting business early on.

**B3a Can I ask how your work is going? What does the future look like?**

**B4 Ask respondents who currently also have employee earnings:**

- occupation, hours worked, location;
- route to current work as employee.

**B4a What experience have you got of working as an employee/other kinds of self-employment/unemployment?**

**B5 I'd like to talk about your self-employed work/business in more detail now. Let's start with your patterns of working. Can you give me an idea of whether your work is regular or fluctuates?**

- regular/fluctuating; pattern of fluctuation; reasons;
- How many hours of work are worked (weekly)?
- What a 'typical day looks like';
- Whether respondent has any 'down time' when they are not doing self-employed or other work? What do they do?

**B6 How does your self-employed work generate income?**

- Sales; fees; payments for services; 'wages' from agency; 'wages' as construction/transport workers; share of business profits; boat share; rent.

**B7 What is the pattern of your income flow? I mean, is it regular or does it fluctuate?**

**B8 And what outgoings and expenses do you have, in your self-employed work?**

- Materials; premises; equipment and tools; clothing; vehicles and fuel; employee wages; licences and business insurance; ongoing training and courses; advertising/marketing.
- Do you have any business loans? Probe for:
  - type, amounts, repayment arrangements.

**B9 What is the pattern of expenses here? I mean, how often are you paying out for these things?**

**B10 What kind of ongoing accounts do you keep?**

- Cash diary; sales and receipts book, box of invoices; profit and loss accounts; keep wage slips.
- Software packages – which ones?
- If a computer tool (for example designed by DWP or HMRC) was available to manage income and expenses, do you think you might use it?
- How often do you do your accounts; how long does it take?

**B11 Does anybody help you keep these ongoing accounts?**

- Who? what kind of help? is there a charge?
- Is there any particular reason why you use ...?

**B12 Do you have a Unique Tax Reference number for income tax and NI contributions?**

**B13 How do you currently report your income for tax; NI (certificate of exception)**

- Probe for frequency; form of reporting.

## C. Experiences of tax credits and benefits

You are currently claiming tax credits, and we are interested in your experiences here. There may be lessons for DWP in putting Universal Credit into operation.

**C1 For tax credits, self-employed income is based on taxable profits (annual turnover less allowable business expenses) for the tax year preceding the year of claim. How did you find this?**

- Did you ever ask for a mid-year adjustment or appeal?
  - reason; outcome; issues arising.

**C2 Have you ever been asked to supply any evidence to support your claim?**

- Evidence supplied; on-line/paperwork; did anybody help you; time involved; expense?
- Did any issues or problems arise?

**C3 Finally, we are interested in how you actually use tax credits. Do you use the money for anything in particular?**

- whose/which account(s) are they paid in to (for example, household budgeting; business expenses)?

## D. How Universal Credit will affect you

**D1 Can I just start by asking you about the idea of increasing your hours or your income? Would you be able or willing to do this?**

- Do you think you would need help or advice to do this?
- Where would you want that advice from?

**D2 The DWP is currently working on guidance about what will be acceptable as evidence but has some ideas. So, can I ask you whether you would be able to produce any of these (i.e. take them to an interview) ...?**

- Diaries of appointments.
- Lists of customers and suppliers.
- Proof of tax registration with HMRC.
- Marketing materials to secure new business.
- A business plan.
- Receipts for purchases/business expenses.
- Order and sales records.
- Bank statements.
- Cash book for cash income activity/transactions.

- Probe: some of these have actually been used fraudulently in the past and DWP are looking for help in how they can assess what's genuine or not. So, how would you say they should be convinced that your (insert as appropriate) is genuine?

**D3 If you were free to bring any other evidence is there anything you could produce to show you were genuinely doing self-employed work for over half your time and looking to increase your income?**

- Probe for details.

**D4 Under Universal Credit self-employed people will be expected to report 'cash in' and 'cash out' on a monthly basis, on- line.**

- Would you be able to do this?
- How would you do it? Which person will do it?
- How easy? How much time involved? Would you need support? Additional expense? e.g. people whose accountant draws up end of year accounts.
- Probe: for general use of IT, and support used.

**D4a (Now show screen grab). This is a draft of the on-line form that DWP might ask you to complete. Have a look. How does this look to you? Does it make sense?**

- Are the categories that are being suggested clear?
- Can you think of any of your expenses that would be a problem fitting in?

**D5 There is likely to be a requirement that you report your income within seven days of the end of each month. Would that be feasible for you?**

- Probe for how easy or difficult meeting this requirement is likely to be.
  - Probe for reasons for difficulties;
  - What would be a reasonable period for them?

**D6 So, let's suppose your Minimum Income Floor was £220 a week (This is likely to be around the maximum figure). That means if your income is less than £220 this is still the figure that goes into the Universal Credit calculation. Do you have any initial views about this?**

**D7 Do you think that you would drop below this Minimum Income Floor very often?**

**D8 Can we have a similar discussion but with a different figure. £110.**

**D9 If you went below the Minimum Income Floor you would get less overall income for the next month. Did you understand this?**

- Do you think you would change how you think about self-employment?
  - For example, would you think of trying to increase your income so it didn't go lower than the Minimum Income Floor in future? How would you do that? Would it be easy? Probe for why/why not.
  - Would you consider looking for paid work for an employer? If so, would that be to complement self-employment or replace it?
  - What would be the effect on your self-employment if your income dropped by, say, £50 a week?

**D10** It is planned that people new to self-employment, meaning in their first year, will not have the Minimum Income Floor applied to them, but they might be required to attend quarterly Gateway interviews. What do you think of this?

- Probe for thoughts about the time period of one year.

**E.** Other views of Universal Credit

**E1.** Just to remind you that some of the questions have been to explore some of the ideas the DWP has about Universal Credit. Nothing has been decided finally yet. So have you any other views or thoughts about how Universal Credit could be designed to suit you as a self-employed person?

- |  |
|--|
| <ul style="list-style-type: none"><li>• Thank you very much.</li><li>• Remind about confidentiality and use of the data.</li><li>• Participants to sign for £30 (if not dealt with earlier).</li></ul> |
|--|

**End of interview**

# Appendix C

## Extract from online self-employed earnings form


Universal Credit

Home
Sign out

YOUR UNIVERSAL CREDIT CLAIM

### Self employed earnings

Currently 75% complete in this section

**Tell us about your income** [What does this mean](#) ▾

**Money you have earned** [What does this mean](#) ▾

Income received from self employment    £

**Money you have spent** [What does this mean](#) ▾

Regular business costs [What does this mean](#) ▾    £

Stock [What does this mean](#) ▾    £

Expenses [What does this mean](#) ▾    £

Regular business costs [What does this mean](#) ▾    £

New equipment [What does this mean](#) ▾    £

Tax (not arrears)    £

National insurance    £

Pension contribution    £

Calculate total    £

I have only reported income and expenses for the period **01/07/2013 - 01/08/2013**. I understand I can only claim the following amounts as deduction for payments in the assessment period if I have already incurred the cost in the assessment period(month) and have receipts to verify. I understand I may be investigated and liable to prosecution if I misreport my income from self employment.

← Back
Next →
Exit section



Home
Sign out

### YOUR UNIVERSAL CREDIT CLAIM

## Self employed earnings

Quantity 77% complete in this section

**Tell us about your income** What does this mean?

You must tell us about your income from self employment received as a result of the service, trade, profession or self-employed work carried out. All expenses must be wholly and exclusively for the purpose of your self-employed activity. You report your income from self employment at the end of each assessment period. You can access a tool to help with your monthly expenses by [clicking here](#).

**Money you have earned** What does this mean?

Include all money earned in the assessment period including payment in kind, payments & income (including both transactions payments for services). Do not carry forward any negative balances of income. Do not include money received from a loan as money you have earned.

Income received from self employment: £

**Money you have spent** What does this mean?

Complete each of the following to record your costs during the assessment period. Put £0.00 if you have not incurred any cost or expense for any of the items listed.

**Regular business costs** What does this mean? £

Which items do you need for the business, but all primarily for your business? (Excludes items that you can't claim for depreciation or write off, and don't include a car for a private hire.)

**Stock** What does this mean? £

Used to have contracts with supporting people

**Expenses** What does this mean? £

If you use your car for business purposes then the mileage you will be permitted to use for tax purposes is a general deduction. However, deductions for mileage are only if there is no tax calculation for trading then it can be a general deduction. It is a deduction that may be deducted.

**Mileage covered in the assessment period:**

- 1) The number of miles that you have used for business during the assessment period is:
  - a) 0 to 1000 miles and you are permitted to deduct 45 p per mile.
  - b) 1001 to 10000 miles and you are permitted to deduct 25 p per mile.
  - c) more than 10000 miles.
- 2) The number of miles that you have used for business during the assessment period is:
  - a) 0 to 1000 miles and you are permitted to deduct 45 p per mile.
  - b) 1001 to 10000 miles and you are permitted to deduct 25 p per mile.
  - c) more than 10000 miles.

**Have you earned?** What does this mean? £

**Tax and other deductions explained in the following table**

Tax that amounts	£ <input type="text"/>
National insurance	£ <input type="text"/>
Pension contribution	£ <input type="text"/>

**Calculate total** £

I have only reported income and expenses for the period 01/01/2013 - 31/03/2013. I understand that only claim the following amounts as deductions for payments in the assessment period if I have already incurred the cost in the assessment period/month and have receipts to verify. I understand I may be investigated and liable to prosecution if I misreport my income from self employment.

Back
Next
Exit section

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**This report presents findings from research with self-employed tax credit claimants, commissioned to support the move to Universal Credit.** The study set out to learn how current experiences of claiming tax credits might inform: the continuing development of Universal Credit policy and delivery; 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.

If you would like to know more about DWP research, please email:  
[Socialresearch@dwp.gsi.gov.uk](mailto:Socialresearch@dwp.gsi.gov.uk)

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Work and Pensions

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