

Chapter V5: ESA and self-employed earners

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Chapter V5: ESA and self-employed earners

Self-employed earners

General

V5001 ESA has no condition of entitlement based on income and so earnings are not taken into account against the amount of ESA paid to the claimant. However, where a claimant who is entitled to ESA is working then the guidance in this chapter should be used to identify

1. the type of earnings **and**
2. the weekly amount of those earnings.

The level of earnings will then determine whether the work is within the PWK limits¹. ADM Chapter V3 provides guidance on the effect of work on ESA.

1 ESA Regs 13, reg 39 & 76(8)

V5002 It is only the amount of a claimant's own earnings that may affect entitlement to ESA on the grounds of whether the level of earnings is within the PWK limits¹.

1 ESA Regs 13, reg 39

V5003 - V5006

Who is a self-employed earner

V5007 A S/E earner is a person who is gainfully employed

1. in GB **and**
2. in employment that is not employed earners employment¹.

Note: A person may also be employed as an employed earner. This does not stop the person being S/E.

1 ESA Regs 13, reg 2; SS CB Act 92, s 2(1)(b)

V5008 A S/E earner enters into a contract for services to a customer

1. on a sole trader basis **or**
2. in partnership with others.

V5009 S/E earners are responsible, to the full extent of their personal fortune, for the debts of the business and are entitled to **either**

1. in the case of a sole trader, all the profits **or**
2. if in a partnership (see V5400), the agreed share of the net profits.

V5010 A person may be S/E and also have other work as an employed earner. If so the earnings from each employment should be calculated separately.

V5011 To determine if a person is, or has been a S/E earner, the DM should have regard to a number of factors. A determination should be made after weighing up the answers to the following

1. Is the person's work supervised? A lack of supervision may point towards self-employment.
2. Does the person have the powers of appointment and dismissal and can they employ a substitute? A power to appoint a substitute may point towards self-employment.
3. In what form does remuneration take? Taxation paid at source may suggest that the employment is not S/E.
4. How long in duration are the contracts of work? Short contracts may point towards self-employment.
5. Does the person provide their own equipment? Provision of own equipment may point towards self-employment.
6. Where does the person work? Working from home may point towards self-employment.
7. Is the person who engages the person for work obliged to provide work? If there is no obligation then this may point towards self-employment.
8. Does the person have discretion to the hours of work? The greater the discretion, the more likely that the work is self-employment.

V5012 - V5014

Directors of limited companies

V5015 A limited company is a legal person¹ and is different from a sole trader or partnership because

1. the company belongs to its shareholders, who share in any distributed profits according to the size of their individual holding **and**
2. the liability of each shareholder is limited to the number of shares taken, or the amount that the shareholder has stood as personal guarantor for. The shareholder is not liable for any amount above the amount unpaid on shares (if any) or the amount guaranteed **and**
3. if 2. does not apply, liability for debts is limited to the company's capital.

1 R(SB) 57/83

V5016 A limited company, of whatever size, is separate from its employees, officers and shareholders¹. This means that the profits of the company do not belong to the

directors. A director of a limited company is an office holder in the company² and is an employed earner (see ADM Chapter V4).

1 R(SB) 57/83; 2 McMillan v Guest 1942, AC 561

Earnings of self-employed earners

V5017 In S/E cases, earnings are the gross receipts (see V5125) of the employment¹.

1 ESA Regs 13, reg 82(1)

V5018 S/E earnings do not include

1. charges paid to the S/E earner in return for providing BL accommodation¹ (see V5019) **or**
2. any sports award².

1 ESA Regs 13, reg 82(2)(a); 2 reg 82(2)(b)

Board and lodging accommodation

V5019 BL accommodation is accommodation¹

1. where the charge for the accommodation includes some cooked or prepared meals that are both
 - 1.1 cooked or prepared by someone who is not
 - 1.1.a the person provided with accommodation **or**
 - 1.1.b a member of the family of the person provided with accommodation **and**
 - 1.2 eaten in that accommodation or associated premises **or**
2. provided to a person in a
 - 2.1 hotel **or**
 - 2.2 guest house **or**
 - 2.3 lodging house (see V5020) **or**
 - 2.4 similar establishment **or**
3. that is
 - 3.1 not provided by a close relative (see V5021 - V5022) of
 - 3.1.a the person provided with accommodation **or**
 - 3.1.b a member of the family of the person provided with accommodation **or**
 - 3.2 provided on a commercial basis.

1 ESA Regs 13, reg 82(3)

V5020 A lodging house

1. is not a private house in which rooms are rented, even if services such as the provision of and washing of bed linen are provided **and**
2. is a place where accommodation is offered on a long-term basis **and**
3. is the kind of establishment that may have a sign outside offering accommodation.

V5021 A close relative is¹

1. a parent, parent-in-law, son, son-in-law, daughter, daughter-in-law, step-parent, step-son, step-daughter, brother, half-brother, sister, half-sister **and**
2. the partner of any of those persons in 1..

1 ESA Regs 13, reg 2; R(SB) 22/87

V5022 For the purposes of V5021, a child who is adopted becomes

1. a child of the adoptive parents **and**
2. the brother or sister of any other child of those parents.

The child stops being the child of, or the brother or sister of any children of the natural parents. Whether an adopted person is a close relative of another person depends upon the **legal relationship** and not the blood relationship¹.

1 R(SB) 22/87

Deciding if a person is a self-employed earner

V5023 To determine whether a person is still trading and therefore still gainfully employed as a S/E earner, the DM should consider the following:

1. if there is a reasonable prospect of work in the near future **and**
2. if the business is a going concern and regarded as such by
 - 2.1 the person **or**
 - 2.2 the business's bankers **or**
 - 2.3 any creditors **or**
 - 2.4 others **and**
3. if the person hopes or intends to restart work in the business when economic conditions improve **and**
4. if the person is undertaking any activities in connection with the self employment **and**
5. if there is work in the pipeline **and**
6. if the person is regarded as S/E by HMRC **and**

7. if the person claims to be anxious for work in the S/E occupation, trade or business. Is the person making it known that the business can take on work¹?
For example,
 - 7.1 by advertising **or**
 - 7.2 by visiting potential customers **and**
8. if the interruption in question is part of the normal pattern of the
 - 8.1 person's work **or**
 - 8.2 work that the person is seeking.

1 Vandyk v. Minister of Pensions & National Insurance [1955] IQ29

V5024 All eight factors in V5023 should be considered in **all** cases where a person who has been working as a S/E earner is now without work. This includes

1. people unable to work because of sickness
2. seasonal workers
3. sub-contractors **and**
4. share fishermen.

V5025 Some of the factors in V5023 may point toward the fact that a person is still trading as S/E. Others may not. No one factor is decisive. The DM should consider the weight to give each relevant factor.

V5026 The DM should make a determination on gainful employment based on a balanced view of the evidence. These are matters of individual judgement for the DM concerned.

Example

Ira runs a business that supplies and fits doors and windows. Because of the competition in the area the business has received fewer and fewer orders, until now there are none. Ira states that

1. he has been unable to pay the rent on his shop and the landlord is threatening eviction **and**
2. his bank has advised that the business should be wound up **and**
3. he still has an advertisement in the Yellow Pages.

The DM decides that the business is no longer a going concern and that Ira is not gainfully employed.

Sickness

V5027 If a S/E earner is unable to work in the business due to sickness, the DM should consider

1. the guidance at V5023 - V5026 **and**
2. whether the person remains gainfully employed as a S/E earner.

V5028 A S/E earner will experience occasional minor illnesses like anyone else. The DM should regard the periods of minor illness as part of the normal pattern of the self employment.

Example 1

Will is a S/E plumber. He is a sole trader. He claims ESA as he has broken both his legs and has been advised by his doctor to avoid work for six months. Will states that

1. his business activity depends entirely on his ability to work and until his legs have healed he cannot undertake any work in connection with his business
2. he has had to advise customers that he is unable to carry out the work that he had arranged so that they can find alternative contractors
3. he and his bank do not consider the business as a going concern
4. he intends to restart work in the business when his leg has healed so he has not removed any of his advertisements in case any contracts can be arranged for when he returns to work.

The DM considers the guidance at V5023 - V5026 and determines, in this case, that self-employment has ceased.

Example 2

Liza is the owner of a fish and chip shop. She claims ESA because she has had a serious operation and has been advised by her doctor to avoid work for three months. Liza states that the fish and chip shop continues to trade with day to day management taken over by her sister-in-law.

The DM considers the guidance at V5023 - V5026 and determines, in this case, that Liza remains gainfully employed as a S/E earner.

V5029 - V5050

Assessment period for self-employed earners

V5051 The normal weekly earnings of a S/E earner should be calculated by using the

1. gross receipts (see V5125) **and**
2. expenses paid out (see V5190)

during the assessment period.

Note: The assessment period for determining earnings from self-employment should **not** be confused with the ESA Assessment Phase (see ADM Chapter V1).

Business trading for less than a year

V5052 If the business has been trading for less than a year, the assessment period should be a period that will allow the DM to calculate the earnings most accurately¹.

1 ESA Regs 13, reg 77(1)(b)

Example

Luke is a S/E window cleaner. He started doing occasional window cleaning jobs in February but it was not until May of the same year that the business really got off the ground.

The DM decides to use an assessment period starting from 1 May to 31 October as the figures produced for this period would most accurately reflect the current level of earnings.

Business trading for more than a year

V5053 If the business has been trading for more than a year and there is no change likely to affect the normal pattern of business, the assessment period should be a year¹ (but see V5167 - V5168).

1 ESA Regs 13, reg 77(1)(a)

V5054 The year does not need to be the year immediately before the claim or the date the award is being looked at. If profit or loss accounts are available for the last trading year the DM can use these as the assessment period. The profit and loss accounts should be converted to a cash flow basis (see V5101 - V5111).

V5055 A year means a period of

1. 365 days **or**
2. 366 days if the assessment period includes the February of a leap year.

V5056 - V5059

Change likely to affect the normal pattern of trading

V5060 If there has been a change that is likely to affect the normal pattern of trading, the assessment period should be a period that will allow the DM to calculate the earnings most accurately¹. The period does not need to be made up of complete weeks.

1 ESA Regs 13, reg 77(1)(b)

V5061 The assessment period should

1. normally start on the date the change affecting the pattern of the business occurred (but see V5064) **and**
2. end on the date that the most recent figures regarding earnings and expenses are available, for example, the next week or month.

V5062 The earnings would then be averaged over that period and apportioned on a weekly basis until the figures for the following week or month become available. The assessment period would then be extended. The assessment period would

1. start on the date the change affecting the pattern of business occurred **and**
2. end on the date that the new figures became available.

The DM should supersede if the new figures affect entitlement to ESA. Where entitlement is not affected, a decision not to supersede should be made if the claimant asked for earnings to be looked at again. For further guidance on supersession including the effective date rule, see ADM Chapter A4.

V5063 This procedure should continue until the assessment period has been extended to one year and the earnings can be averaged over that year (see V5053). In most cases this procedure will provide the most accurate determination of a S/E earner's earnings (but see V5064).

Example

Carlo is S/E, he buys and sells Italian wine. On 9 August Carlo's business goes into receivership. He continues to trade but he lost some of his suppliers and customers.

The DM decides

1. Carlo is gainfully employed

2. that the receivership is a change that has affected the normal pattern of trading
3. that the assessment period is from 9 August (the date the change affecting the pattern of business occurred) to 30 October (the date that the most recent figures for gross receipts and expenses are available).

The earnings for the assessment period are averaged for that period and apportioned on a weekly basis until 30 November when the figures for the following month become available.

At this point the DM extends the assessment period. The assessment period is now 9 August to 30 November. The earnings for this period are averaged and apportioned on a weekly basis until 31 December when the figures for the following month become available.

The DM continues with this procedure until the assessment period has been extended to one year.

V5064 When considering the assessment period the DM should consider the facts of each case carefully. A period that does not start with the first day of the interruption may sometimes give a more accurate determination of the S/E earner's earnings. If so, that period should be used instead.

V5065 The DM should be satisfied that any change

1. has affected **or**
2. is likely to affect

the normal pattern of trading.

Example 1

Lucy works as a S/E draughtsman providing technical drawings for builders. Most of her work comes from one particular building firm. Six months ago the building firm went into receivership.

The DM determines that

1. there had been a change that had affected the normal pattern of business **and**
2. the assessment period starts from the date Lucy lost her major customer.

Example 2

Joe is a S/E roofer. The business has been trading for five years. Joe has not been able to work due to a period of severe snowy weather. The period he was unable to work was ten days.

The DM determines that, although the bad weather might be a change, it was not one that would affect the normal pattern of business. The normal pattern of business would include times in the winter when roofing work could not be done.

Note: Weather conditions that are exceptional for the area could be regarded as a change affecting the normal pattern of business.

V5066 - V5068

New businesses

V5069 A claimant may start up a new business

1. at the same time as claiming ESA **or**
2. whilst in receipt of ESA.

No income should be taken account of until the S/E earner starts to receive actual earnings. When the first payment of earnings is received the DM should use the assessment period

1. starting on the first day of the benefit week in which the person started S/E **and**
2. ending on the last day of the benefit week in which actual earnings are received.

V5070

V5071 The assessment period should be extended every week or month until a yearly assessment is possible (see V5062). In most cases this procedure will provide the most accurate determination of a S/E earner's earnings (but see V5072).

V5072 When determining the assessment period for new businesses the DM should consider the facts of each case carefully. A period that does not start with the first day of self-employment may sometimes give a more accurate determination of the S/E earner's earnings. If so, that period should be used instead.

V5073 - V5099

Calculation of normal weekly earnings

V5100 V5101 - V5244 provides guidance on the calculation of earnings of most S/E earners. Specific guidance is given for

1. child minders (see V5350)
2. crofts or small holdings (see V5361)
3. farmers (see V5370)
4. hotels, guest houses, bed and breakfast establishments etc (see V5380)

5. partnerships (see V5400)
6. renting out property (see V5425)
7. seasonally S/E (see V5440)
8. sub-contractors (see V5450)
9. actors and entertainers (see V5452).

Evidence - cash flow

- V5101 To calculate the amount of earnings the DM will need evidence of
1. the gross receipts (see V5125) **actually received**, not money owed to the business **and**
 2. expenses defrayed, that is, **actually paid for**, not unpaid bills

for the assessment period. This is known as cash flow and evidence should be presented on a cash flow basis.

- V5102 On a claim to ESA, the onus is on the S/E earner to provide the evidence necessary to support the claim. A claimant who is S/E should be asked to submit details of

1. the business **and**
2. **actual** gross receipts and expenditure

during the assessment period.

- V5103 The figures provided in V5102 **2.** should be accepted as accurate unless

1. there is reason to doubt **or**
2. they are unrepresentative of the current trading position.

Supporting evidence of every item of expenditure, or receipt, is not always required. Totals for the assessment period are acceptable provided that each type of expenditure, or receipt is separately detailed and **1.** or **2.** does not apply.

V5104

Accounts

- V5105 A person may submit a set of accounts as evidence of S/E earnings. Accounts provide some, but not all, of the information required by the DM to decide the amount of the gross receipts and expenses paid for.

- V5106 A set of accounts consists of two main statements

1. the **balance sheet**: that is, a statement of the financial position of a business at a given date **and**
2. the **profit and loss account**: that is, a summary of the results of a business's transactions for a period ending on the date of the balance sheet.

V5107 Accounts are prepared using accounting principles. Accounts may include **anticipated** receipts and expenses for the accounting period. The anticipated amounts are not

1. gross receipts as they have not been received by the business **or**
2. allowable expenses as they have not been paid for.

V5108 If accounts are submitted as evidence the S/E person should be asked to provide evidence of actual amounts received and expenses paid so that the evidence can be converted into a cash flow basis. The S/E person can do this by providing

1. accounts that are calculated on a cash flow basis **or**
2. evidence of the gross receipts and expenses paid.

V5109 The figures provided in V5108 **1.** and **2.** should be accepted as accurate unless

1. there is reason to doubt **or**
2. they are unrepresentative of the current trading position.

Supporting evidence of every item of expenditure, or receipt, is not always required. Totals for the assessment period are acceptable provided that each type of expenditure, or receipt is separately detailed and **1.** or **2.** does not apply.

V5110 The S/E person should be asked any questions that cannot be resolved. It may be necessary for the S/E person to provide further supporting evidence, for example

1. bank receipts
2. purchase receipts
3. expenses for a different assessment period.

V5111 As profit and loss accounts are prepared using normal accounting principles, they include certain entries that would not be included in a cash flow account. For example

1. the value of stock at the start and end of the accounting period
2. money owed to the business by debtors
3. money owed by the business to creditors
4. depreciation of assets of the business.

As the DM is considering the S/E person's cash flow, these will not be allowable expenses.

V5112 - V5115

Income tax certificate

V5116 The DM should not accept as conclusive evidence of the weekly net profit an

1. income tax certificate **or**
2. accountant's statement of the net profit figure that is acceptable for tax purposes.

Method of calculation

V5117 To calculate the earnings of a S/E earner the DM

1. should establish the **gross receipts** of the business during the assessment period (see V5125) **and**
2. deduct from the gross receipts the **allowable expenses** that have been paid out during the assessment period (see V5206) **and**
3. deduct from any remaining figure amounts for
 - 3.1 notional income tax (see V5270 et seq) **and**
 - 3.2 notional NI contributions (see V5297 et seq) **and**
 - 3.3 half of any premium paid for a personal pension scheme (see V5326)

The figure that is left is the earnings that should be taken into account¹.

1 ESA Regs 13, reg 83(1)

V5118 The whole process can be summarized as follows

gross	less
allowable	less
notional income tax	less
notional NI contributions	less
half of any personal pension scheme	divided by
the number of days in the assessment period	multiplied by
7 to give a weekly figure	equals
the weekly net profit	equals
the weekly earnings to be taken into account.	

V5119 - V5124

Gross receipts

V5125 Any payment of income actually received by the business during the assessment period, regardless of when it is earned should be included as a gross receipt¹. V5167 provides guidance for payments received that relate to a period different to the assessment period.

1 ESA Regs 13, reg 83(3)

V5126 The gross receipts of a business include

1. any payments for goods and services provided (see V5127)
2. earnings payable abroad
3. certain allowances paid to assist in carrying on the business¹ (see V5135)
4. any business subsidies or payments of compensation (see V5138)
5. personal drawings (see V5139)
6. income from letting or sub-letting (see V5154)
7. sale of certain business assets (see V5155)
8. tips and gratuities (see V5156)
9. payments in kind (see V5158)
10. any VAT receipts (see V5160).

1 ESA Regs 13, reg 82(1); E & T Act 73, s 2; Enterprise and New Towns (Scotland) Act 90, s 2

Payments received for goods and services provided

V5127 All

1. cash **and**
2. cheques **and**
3. credit card payments

received in return for goods and services supplied, should be included as a gross receipt of the business.

V5128 - V5134

Schemes to help with self-employment

V5135 An allowance may be payable under certain schemes to assist people to become S/E. In a business partnership one or all of the partners may be receiving payments.

V5136 Any allowance paid into the S/E earner's business bank account during the assessment period should be included in the gross receipts of the business¹.

1 ESA Regs 13, reg 82(1)

V5137

Business subsidies or payments of compensation

V5138 Some businesses may receive

1. subsidies, for example businesses involving farming or agriculture receive subsidies from the Department for the Environment, Food and Rural Affairs (DEFRA), or the EU **or**

2. payment of compensation from another person because of disruption to the business. For example payments of compensation awarded because of BSE.

Such payments should be included in the gross receipts of the business.

Personal drawings

V5139 A S/E person may draw money from the business for day to day expenses. These drawings, known as personal drawings, are in anticipation of profits or business income and should be included as part of the gross receipts of the business. It is possible for personal drawings to exceed the eventual profit.

V5140 Where drawings are made in excess of the profits of the business they should be treated as capital in the hands of the claimant. Money taken from the business in excess of profits comes from

1. capitalized profits from earlier years **or**
2. increased borrowing.

In **1.** or **2.** the drawings are withdrawals from the capital of the business.

V5141 If personal drawings are declared the DM should establish if the amount has been deducted from the amount shown as the gross receipt. If it has, the amount of the drawings should be added back to the amount of the gross receipts.

V5142 A S/E person who is a sole owner of, or a partner in, a business may pay interest to the business on money taken as personal drawings. These payments should be included in the gross receipts of the business.

Example 1

Kim is a S/E earner. His assessment period is twelve months. He produces evidence of his gross receipts and expenses for the assessment period. Personal drawings are shown as an expense and are not included in the gross receipts of the business.

The DM determines

1. that the personal drawings should be added to the gross receipts of the business **and**
2. allowable expenses should be deducted from this new gross receipts figure.

Example 2

Tahira is a S/E earner. Her assessment period is twelve months. She produces evidence of her gross receipts and expenses for the assessment period.

Personal drawings are shown as an expense and are not included in the gross receipts of the business. It appears from the figures that the personal drawings may exceed any profit.

The DM calculates the net profit without including the personal drawings as a gross receipt of the business. This calculation shows that the personal drawings exceed the net profit of the business.

The DM determines

1. that personal drawings equal to the amount of the net profit previously calculated should be added to the gross receipts of the business **and**
2. allowable expenses should be deducted.

V5143 - V5153

Income from letting or sub-letting

V5154 Any income received from letting or sub-letting of business premises or land should be included in the gross receipts of the business. Any expense connected with the letting should be included with other business expenses.

Sale of certain business assets

V5155 The amount received from the sale of a capital asset should not be included in the gross receipts of the business, unless the asset was part of the stock in trade of the business¹.

1 R(FC) 1/97

Example

Sean runs a business that manufactures computers. The sale of these computers is included in the gross receipts of the business. But when Sean sells a computer that he uses to keep his business records on, the amount received for this computer is not included in the gross receipts of the business (see V5166).

Tips and gratuities

V5156 Tips or gratuities received in response to the service provided by a S/E earner, for example as a hairdresser, taxi driver or coach driver, should be included in the gross receipts of the business.

V5157 Any tips or gratuities that are made as a gift unconnected to the self-employment, for example, on personal grounds should not be included in the gross receipts of the business.

Payments in kind

V5158 If a S/E person is paid in kind the DM should decide a monetary value equal to what would have been paid and include this amount in the gross receipts of the business.

Example

Terri does some work for a local farmer on a S/E basis. The farmer pays Terri for the work in the form of farm produce.

The DM values the produce at what it would have cost if bought from the farmer (or a local grocer), and includes that amount in the gross receipts of the business.

V5159

VAT

V5160 A S/E person who is registered for VAT is required to submit three monthly returns to HMRC showing amounts of

1. VAT collected from customers - known as output tax **and**
2. VAT paid by the S/E person to supplier - known as input tax.

If **1.** exceeds **2.** the S/E person pays the difference to HMRC. If **2.** exceeds **1.** the S/E person receives the difference from HMRC.

V5161 Where

1. a business is registered for VAT **and**
2. in the assessment period the amount received is greater than the amount paid to HMRC

the difference should be included in the gross receipts of the business. This is the amount that V5160 **2.** exceeds V5160 **1.**.

Note: VAT can also be an allowable expense of the business, see V5211 - V5212.

V5162 - V5165

Capital receipts

V5166 Capital receipts do **not** form part of the gross receipts of the business¹. For example,

1. loans
2. injections of capital
3. grants from the Prince's Trust **and**

4. proceeds from the sale of business assets, unless that asset was part of the stock in trade of the business (see V5155).

1 R(FC) 1/97

Income for a different period

V5167 A payment of income **may** be assessed over a period different to the assessment period if the normal weekly amount of the item of income can be established more accurately¹.

Note: The DM should not consider any payment made before or after the assessment period.

1 ESA Regs 13, reg 83(9)

V5168 It is not intended that every payment is assessed individually over a period different to the assessment period. This should be the exception rather than the rule. So, any payment for a period

1. equal to or shorter than the assessment period should be assessed over the full length of the assessment period **or**
2. longer than the assessment period should be converted on a pro rata basis to represent the length of the assessment period.

Example

Roddy is a S/E earner. He receives a payment that is a half-yearly payment under a long-term contract. As the level of trading has changed recently due to a fire on the business premises the assessment period used is 13 weeks.

The DM considers that

1. the payment should be multiplied by 13 and divided by 26 **and**
2. the resulting sum should be added to any other gross receipts of the business.

V5169 - V5189

Business expenses

Conditions for deducting business expenses

V5190 When calculating the net profit of a S/E earner the DM should deduct from the gross receipts any business expense that¹

1. was paid out wholly and exclusively for the purposes of the business² **and**
2. was paid out during the assessment period **and**
3. was reasonably incurred³ (see V5198) **and**
4. is an allowable expense (see V5206).

Wholly and exclusively

V5191 An expense is wholly and exclusively paid out when it has been incurred only for the purpose of the business¹. Any such payment should be deducted in full, subject to V5190 2. - 4.

1 ESA Regs 13, reg 83(3)

Expenses for both business and private use

V5192 If expenditure is for both business and private use, for example

1. a business that is run from home **or**
2. there is only one vehicle for both business and private use

the DM should apportion the cost. Only the portion of the expenditure that is wholly attributable to the business can be deducted.

V5193 It is a common practice for a S/E person to put private expenses through a business account. If a set of accounts has been submitted as evidence of expenses the DM should establish the amount of the expenses paid out for the business.

V5194 The DM should normally accept the evidence of

1. the S/E earner **or**
2. an accountant **or**
3. any apportionment already agreed by HMRC for tax and contribution purposes¹.

1 R(FC) 1/91; R(IS) 13/91

V5195 Examples of expenses that may be apportioned between private and business use are¹

1. telephone calls and telephone rental
2. motor expenses such as fuel, road fund license (sometimes called road tax), insurance premiums, servicing, maintenance or repair charges
3. fuel costs and standing charges for gas and electricity.

1 R(FC) 1/91; R(IS) 13/91

Example 1

Shanta runs a business from her home. She uses the telephone for private and business use. The total cost of telephone charges in the assessment period is £300.

Shanta provides evidence that HMRC have agreed that the apportionment is 60% for business use and 40% for personal use.

The DM decides that £180 of the expenses have been reasonably incurred and allows this amount when calculating Shanta's net profit.

Example 2

Alan uses a car for both business and private use. The total cost in the assessment period is £750. Alan provides information that 55% of the cost is for business use and 45% is for personal use.

The DM decides that this is reasonable and allows £412.50 as an expense.

Example 3

Darcy is a dressmaker who works at home using an electric sewing machine. She uses an electric fire to heat the room when working. A quarterly electric bill is included as a business expense but no breakdown is given of business and private use.

The DM apportions the expenses so that only the part that is wholly and exclusively for the business is allowed. To do this the DM makes a determination based on all the facts, including

1. the size of the working area in relation to the rest of the rooms
2. how many other people live in the home
3. what amount Darcy thinks represents business use
4. how many hours are spent working and using the appliances
5. what other electrical appliances are used in the home.

V5196 - V5197

Reasonably incurred

V5198 The term “reasonably incurred” is not defined in legislation. It should be given its ordinary everyday meaning. To be reasonably incurred an expense must be

1. appropriate to the business **and**
2. necessary to the business **and**
3. not excessive.

The DM should consider the nature of the business, level of trading and if there are any employees.

V5199 To determine what is reasonable the DM should have regard to the circumstances of each individual's case¹, including the level of the person's earnings².

V5200 The DM may have to consider if it is reasonable for a person to reduce the by employing someone to do part of the work of the business. To determine if this expense is reasonably incurred the DM should consider all of the circumstances of the individual case including if the

1. person is capable of doing the work **and**
2. evidence suggests that the person is employing another so that the remunerative work condition is satisfied.

The DM may conclude that the expense of employing another person is not reasonably incurred, therefore cannot be deducted from the gross receipts.

V5201 If expenditure on a particular item is necessary to enable the person to run the business, the whole of that expenditure may be a deductible expense unless there is evidence that it is excessive¹.

1 R(G) 7/62

V5202 If the DM is not satisfied that the whole of an expense is reasonably incurred only the part that is considered to be reasonable should be allowed as a deduction against gross receipts.

V5203 - V5205

Allowable business expenses

V5206 If the conditions in V5190 **1. - 3.** are met, all day to day expenses of a business are allowable, including¹

1. accountancy charges
2. advertising costs
3. certain capital repayments on a loan used to²
 - 3.1 replace an item of equipment or machinery that has
 - 3.1.a worn out in the course of the business **or**
 - 3.1.b become outdated **or**
 - 3.2 repair an existing asset, but only to the extent that the loan exceeds any sum paid or due to be paid under an insurance policy for that repair, for example, labour may not be covered by the policy
4. cleaning of business premises
5. employee's wages before any deductions, including wages payable to a partner, but not a business partner (see V5210)
6. employer's contribution to an employee's pension scheme
7. employer's secondary Class 1 NI contributions
8. heating and lighting

9. hire or rental costs, but not any capital or purchase elements
10. income spent on the repair of an existing business asset, but only to the extent that cost of the repair exceeds any sum paid or due to be paid under an insurance policy for that repair³
11. interest payable on a mortgage, loan, credit sale, consumer credit agreement or a hire purchase agreement - this does not include any capital element, but see 3.⁴
12. legal fees for the running of the business, but not with the setting up or expansion of the business
13. payment in kind for work done for the business - the monetary value is allowed
14. rent, council tax, water charges and insurance premiums on the business premises
15. stationery
16. stock purchases
17. sundries, if the DM is satisfied that the expenses are allowable
18. telephone, fax or telex
19. transport, for example business use of the car including petrol costs, road fund license, insurance and servicing
20. VAT (see V5211)⁵.

This list is not exhaustive.

*1 ESA Regs 13, reg 83(2)(a), reg 83(3), reg 83(4), reg 83(6);
2 reg 83(5); 3 reg 83(7)(b)(ii); 4 reg 83(7)(b)(iii); 5 reg 83(7)(b)(i)*

V5207 For the purpose of V5206 **3.2** an asset includes buildings, plant machinery, vehicles or equipment.

Example 1

Hattie is a mobile hairdresser. She takes out a loan to buy a replacement car as her existing car is beyond repair.

The DM determines that

1. the loan is used to replace a car with a similar item and the capital repayments are allowable **and**
2. interest payments on the loan are allowable.

Example 2

Dermot is a builder. He takes out a loan to buy an additional van after taking on an employee.

The DM determines that

1. the capital repayments on the loan are not allowable because the loan is for an additional item **and**
2. interest payments on the loan are allowable.

Example 3

Miles is a farmer. He takes out a loan to replace a tractor but decides to buy a combine harvester instead.

The DM determines that

1. the capital repayments on the loan are not allowable because the loan is for a different piece of machinery **and**
2. interest payments on the loan are allowable.

V5208 - V5209

Partner's earnings from the business

- V5210 The earnings of a partner (but not a business partner) who is employed in the business should be allowed as a business expense (see V5206 **5.**). The wage should not be added back to the business accounts to offset any loss¹.

1 ESA Regs 13, reg 83(10)

VAT

- V5211 A S/E person who is registered for VAT is required to submit returns to HMRC showing amounts of

1. VAT collected from customers - known as output tax **and**
2. VAT paid by the S/E person to suppliers - known as input tax.

If **1.** exceeds **2.** the S/E person pays the difference to HMRC. If **2.** exceeds **1.** the S/E person receives the difference from HMRC.

- V5212 Where

1. a business is registered for VAT **and**
2. in the assessment period the amount paid to HMRC is greater than the amount received in the same period

the difference should be taken into account as an expense¹. This is the amount that V5211 **1.** exceeds V5211 **2.**.

Note: VAT can also be a gross receipt of the business (see V5161).

1 ESA Regs 13, reg 83(7)(b)(i)

V5213

Expenditure for a different period

V5214 Any business expenditure paid out in the assessment period **may** be assessed over a period different to the assessment period if the normal weekly amount of that item of expenditure can be established more accurately¹.

Note: The DM should not deduct an expense paid before or after the assessment period.

1 reg 83(9)

V5215 It is not intended that every expense is assessed individually over a period different to the assessment period. This should be the exception rather than the rule.

V5216 Any expense for a period

1. equal or shorter than the assessment period should be assessed over the full length of the assessment period **or**
2. longer than the assessment period should be converted on a pro rata basis to represent the length of the assessment period.

Example

Dominic is a S/E taxi driver. He started trading six months before claiming ESA. The assessment period is 26 weeks. In that time the annual road fund licence and insurance on the taxi was paid.

The DM determines

1. that the expenses should be multiplied by 26 (the length of the assessment period) and divided by 52 **and**
2. the resulting figure should be added to any other allowable expenses.

V5217 - V5219

Expenses not allowed

V5220 Business expenses that should not be allowed are

1. those expenses where the conditions for deducting a business expense are not met (see V5190)
2. capital expenditure¹
3. depreciation of capital assets²
4. expenses used, or intended to be used, in setting up or expanding a business³
5. any loss incurred

- 5.1 before the start of the assessment period⁴ **or**
- 5.2 in any other employment⁵
- 6. repayment of capital on loans⁶ except where V5206 3. applies
- 7. business entertainment expenses⁷
- 8. losses incurred on the disposal of a capital asset
- 9. payments into a contingency fund to safeguard against future bad debts⁸
- 10. personal drawings on income and capital
- 11. money on goods used for personal consumption.

*1 ESA Regs 13, reg 83(4)(a); 2 reg 83(4)(b); 3 reg 83(4)(c);
4 reg 83(4)(d); 5 reg 83(10); 6 reg 83(4)(e); 7 reg 83(4)(f); 8 reg 83(6)*

Capital expenditure

V5221 Capital expenditure is the expenditure on fixed assets, sometimes called capital assets. In line with HMRC practice, fixed assets include items such as tools, equipment, machinery and vehicles used in the business. The DM should not allow capital expenditure as a business expense¹.

1 ESA Regs 13, reg 83(4)(a)

Example

Marc is a mobile hairdresser. He buys a replacement car with cash. The replacement car is a fixed asset of the business. The money used to buy it is capital expenditure. The DM does not allow a deduction. But if Marc had taken out a loan to buy the car, repayments of capital and interest would have been allowed as expenses (see V5206).

Depreciation

V5222 Depreciation of a capital, or fixed asset is the amount that the value of that asset is estimated to have reduced, due to age or wear and tear, during the assessment period.

V5223 If there are fixed assets, accounts will always show depreciation as a business expense. The DM should not allow depreciation as a business expense¹.

1 ESA Regs 13, reg 83(4)(b)

V5224 - V5225

Sums used in setting up or expanding a business

V5226 The DM should not allow as a business expense any sum used, or intended to be used, in setting up or expanding a business¹. This applies to expenditure on, for example

1. fixed assets of the business, including fixtures and fittings or the cost of larger premises **or**
2. non-recurring costs such as legal services in obtaining a lease.

Note: If a business loan has been obtained the DM should consider interest on the loan (see V5206 11.) and allow as an expense other items that are ongoing regular expenses.

1 ESA Regs 13, reg 83(4)(c)

Loss incurred before the beginning of the assessment period

V5227 The DM should not allow as a business expense any loss incurred before the beginning of the assessment period¹.

1 ESA Regs 13, reg 83(4)(d)

V5228 - V5229

Loss incurred in any other employment

V5230 A person may

1. have more than one employment as a S/E earner **or**
2. be both a S/E earner and an employed earner, for example a director.

The earnings from each employment should be assessed separately.

V5231 Any business loss in one employment should **not** be offset against the earnings of another employment¹. Also, any loss made by one member of a couple should not be offset against the earnings of another member.

1 ESA Regs 13, reg 83(10)

Example

Ethan is a market trader and a S/E music teacher. The market stall runs at a loss.
The DM

1. considers that the loss from the market stall is not an allowable expense against the gross receipts from teaching music **and**
2. calculates the net profit from each self-employment separately.

Repayment of capital on business loans

V5232 The DM should not allow the repayment of the capital part of a business loan as a business expense unless it is for replacement or repair of an asset¹ (see V5206 3.).

1 ESA Regs 13, reg 83(4)(e)

V5233 - V5234

Business entertainment

V5235 Any expense claimed for providing business entertainment, for example

1. business lunches **or**
2. hospitality in connection with the business

should not be allowed as a business expense¹.

1 ESA Regs 13, reg 83(4)(f)

Loss on disposal of a capital asset

V5236 When an asset is sold for less than the value shown in the books of the business the difference is referred to as the “loss on disposal” and is accepted as a loss for accounting purposes. But the DM should not

1. allow the loss as an expense **or**
2. include the proceeds from the sale of the asset as a gross receipt of the business (see V5155).

Payments into contingency funds

V5237 Any payments into a contingency fund set up to safeguard against future bad debts should not be allowed as a business expense. This is an allocation of funds rather than an expense.

V5238 - V5239

Personal drawings

V5240 Personal drawings may be shown as a

1. trading expense of the business **or**
2. withdrawal of capital on the balance sheet (if produced).

In either case, the drawings should not be allowed as a business expense.

Personal consumption

V5241 The DM should not allow any money spent on goods for personal consumption as a business expense.

V5242 Personal consumption is not limited to food products. It could include a range of items, for example

1. paint
2. spare parts
3. building materials
4. drinks.

- V5243 The DM should not assume
1. personal consumption **or**
 2. if the S/E person is a partner, that the figure for personal consumption will be the same for each partner.

- V5244 If the business is one where personal consumption is likely to arise, for example
1. a farmer **or**
 2. a grocer

and no figure has been declared, enquiries should be made about the nature and value of any produce or goods consumed or used.

V5245 - V5259

Calculation of income tax, National Insurance contributions and qualifying premium

Introduction

- V5260 Having calculated the gross receipts and expenses from self-employment on a cash flow basis, the DM should consider deductions for¹
1. income tax (see V5270 et seq) **and**
 2. Class 2 NI contributions (see V5297 et seq) **and**
 3. Class 4 NI contributions (see V5316 et seq) **and**
 4. half of any premium for a personal pension scheme (see V5326).

1 ESA Regs 13, reg 83(2)(b) & (c)

- V5261 The DM should base deductions for V5260 **1. - 3.** on the chargeable income for the assessment period.

V5262 - V5265

Chargeable income

- V5266 The chargeable income¹, that is, the income chargeable for tax, for the assessment period is the amount of earnings
1. in the case of a S/E child minder, one third of the gross receipts of that employment² **or**
 2. in the case of a partnership, the person's share of
 - 2.1 the gross receipts of the employment less

- 2.2** any allowable business expenses³ **or**
- 3.** in any other case, the person's
 - 3.1** gross receipts of the employment less
 - 3.2** any allowable expenses⁴.

1 ESA Regs 13, reg 84(4); 2 reg 84(4)(b); 3 reg 83(3); 4 reg 83(2)(a)

V5267 The calculation at V5266 **1.** - **3.** should not include any deductions for

- 1.** notional income tax **or**
- 2.** NI contributions **or**
- 3.** premiums for a personal pension scheme.

V5268 - V5269

Deduction for notional income tax

V5270 The DM should use the tax rates and allowances for the year (6 April to 5 April) appropriate to the assessment period which is being used to calculate the earnings.

Example

Andrew makes a claim for ESA in June 2014. The DM accepts as evidence of his earnings his cash flow accounts up to the tax year ending the previous April. The tax rates and allowances used to calculate the notional tax deduction are those for the previous tax year.

Tax allowances

V5271 A tax allowance is an amount of income a person can earn or receive in a tax year without paying tax. There are a number of tax allowances, but for the purposes of calculating the earnings of a S/E earner, DMs should have regard to the personal allowance only. The rates of income tax allowances are in Appendix 1 to this Chapter.

V5272 - V5273

Personal allowance

V5274 All earners whether married or single get a personal allowance. There are three age-related levels of personal allowance (see Appendix 1 to this Chapter), but for ESA purposes only the personal allowance for a person aged under 65 is deducted - even if another personal allowance appears to apply.

Tax rates

V5275 The tax rate is the percentage of taxable income payable to HMRC. Taxable income is the amount of income remaining after deducting tax allowances. The rate is in Appendix 1 to this Chapter.

V5276 - V5287

Calculation of deduction

V5288 To determine the notional amount of income tax to be deducted from a S/E earners chargeable income the DM should¹

1. establish the chargeable income
2. establish the personal allowance appropriate to the S/E earner. If it
 - 2.1 is equal to or greater than the chargeable income there will be no notional income tax to deduct **or**
 - 2.2 is less than the chargeable income, go to 3.
3. deduct the personal allowance (see Appendix 1 to this Chapter)
 - 3.1 in full if the assessment period is a year **or**
 - 3.2 on a pro rata basis if the assessment period is less than a year²
4. multiply £34,370 (12/13 rates) of the remainder (or, if the assessment period is less than a year, a pro rata amount) by the basic rate of tax (see Appendix 1 to this Chapter)
5. round up where necessary.

1 ESA Regs 13, reg 84(1); 2 reg 84(2)

Example

Noah is a married man aged 45. He works as a S/E gardener and claims ESA. The DM determines that the assessment period is for a year and calculates the chargeable income for the assessment period as £15,500.

The DM calculates the notional income tax as follows:

		£	
Chargeable income	-	15,500.00	less
Claimant's personal allowance	-	8,105.00	
		<hr/>	
		7,395.00	
£7,395.00 at 20%	=	1,479.00	
Total notional income tax	=	1,479.00	

V5289 - V5296

Deduction for notional Class 2 NI contributions

V5297 A Class 2 contribution is a flat rate contribution. The same amount of Class 2 contribution is paid by men and women, although a higher rate is paid by share fishermen. The Class 2 rates are in Appendix 2 to this Chapter.

Liability for a Class 2 contribution

V5298 The DM should make a deduction for a notional Class 2 contribution in **all** cases unless the chargeable income is below the small profits threshold (formerly the small earnings exception level). See Appendix 2 for the rates.

V5299 The DM should only consider the chargeable income when deciding if a deduction for Class 2 should be made. If appropriate, a deduction should still be made even if the claimant holds a small earnings exception certificate.

V5300 - V5303

Calculation of the Class 2 contribution

V5304 The deduction for the notional Class 2 contribution should be based on the rate of Class 2 contributions and small profits threshold current at the time of the claim only¹. Take no account of any increases in the contribution rates or small profits threshold. To calculate the amount of the deduction the DM should

1. establish the chargeable income² **and**
2. determine if a deduction should not be made on the grounds of small earnings **and**
3. multiply the weekly rate (see Appendix 2 to this Chapter) by the number of weeks in the assessment period.

1 ESA Regs 13, reg 84(3)(a); 2 reg 84(4)

V5305 - V5315

Deduction for notional Class 4 NI contributions

V5316 A Class 4 contribution is a deduction of a fixed percentage of the annual profits of a business when these profits fall within lower and upper levels (see Appendix 2 to this Chapter). These payments are in addition to Class 2 contributions.

V5317

Calculation of Class 4 deduction

V5318 The deduction for a notional Class 4 contribution should be based on the percentage rate and lower and upper levels current at the date of claim only¹. Take no account of any increases in the percentage rate and lower and upper levels. The DM should

1. establish the chargeable income **and**
2. decide the number of weeks in the assessment period (if there are less than 52 weeks in the assessment period the DM should calculate **3.** on a pro rata basis) **and**
3. deduct the Lower Level from chargeable income up to the Upper Level **and**
4. multiply the remaining figure by the percentage rate to give the notional contribution figure. No account should be taken of evidence of actual payments made or due.

The Class 4 rates are in Appendix 2 to this Chapter.

1 ESA Regs 13, reg 84(3)(b)

Example 1

Assessment period is 52 weeks

Chargeable income is £11,231.57

Class 4 - Lower level is £7,605
- Upper level is £42,475

Chargeable income 11,231.57 **less**

lower level 7,605

Profit 3,626.57 x 9% = 326.40

Notional Class 4 contributions for 52 weeks is £326.40.

Example 2

Assessment period is 39 weeks or $\frac{273}{365}$ days

Chargeable income for this period is £12,958

Class 4 - lower level $\frac{7,605 \times 273}{365}$ = 5,688.13
is

Chargeable income 12,958 **less**

lower level 5,688.13

Profit 7269.87 x 9% = 654.29

Notional Class 4 contributions for 39 weeks is £654.29

V5319 - V5324

Premiums for personal pension schemes

V5325 When calculating S/E earnings the DM should deduct from the chargeable income half of any premium for a personal pension scheme for the relevant assessment period¹.

1 ESA Regs 13, reg 83(1)(b)(ii) & (2)(c)

Example

Parminder runs a small business from home. Her earnings are calculated over a period of a year. Parminder makes contributions under personal pension scheme on a monthly basis. The relevant assessment period is a year.

The DM should calculate the contributions on a yearly basis and deduct half of this sum from the net profit.

Personal pensions

V5326 Personal pension schemes¹ are

1. a scheme under certain pension and taxation legislation² or
2. an annuity contract or trust scheme under certain taxation legislation³.

They provide benefits independently of any employer (although an employer may still make contributions to such a scheme). Benefits are payable as annuities which may provide lump sum and pension payments payable on death or retirement.

1 ESA Regs 13, reg 2; 2 Pensions Schemes Act 93, s 1; Income and Corporation Taxes Act 1988, Chapter 4 of Part 14 & Finance Act 2004, Sch 36, para 1(1)(g); 3 Income and Corporation Taxes Act 1988, s 620 or s 621; Finance Act 2004, Sch 36, para 1(1)(f) & Income and Corporation Taxes Act 1988, s 622(3)

V5327 Taking an income from the pension fund allows the purchase of an annuity to be delayed up to the age of 75. The amount of income to be paid from the fund is recalculated every three years. At the age of 75 an annuity must be purchased.

V5328 - V5349

Particular forms of self-employment

Child minders

V5350 A child minder is a person who engages in a contract for services to care for another person's child in return for payment. Most child minders

1. work from their own homes **and**
2. are registered with the LA **and**
3. are restricted to the number of children they care for at any one time.

V5351 To calculate a child minder's normal weekly earnings the DM should

1. determine the assessment period in the normal way **and**
2. calculate the gross receipts for that period **and**
3. calculate the chargeable income as **one third** of the gross receipts during the assessment period¹ but make no deductions for business expenses **and**
4. calculate a deduction² for
 - 4.1 income tax **and**
 - 4.2 NI contributions **and**
 - 4.3 half of any premium for a personal pension scheme.

1 ESA Regs 13, reg 84(4)(b); 2 reg 83(8)

Example

Fiona is a S/E child minder. Her assessment period is 13 weeks. The gross receipts for that period are £1,280.

The DM determines

1. that no expenses should be deducted from the gross receipts **and**
2. that the chargeable income is £426.67 (1/3 of £1,280) **and**
3. the income tax, NI contributions and premiums that are to be deducted from the chargeable income.

V5352 - V5360

Crofts or small holdings

V5361 Earnings from a croft or small holding should be decided on the same basis as a small business. The person should produce an annual statement giving details of

1. income from sales, subsidies, etc **and**
2. expenditure, including for example, seed, fertiliser, feed and labour.

This statement should be used to calculate the person's net profit.

V5362 - V5369

Farmers

V5370 A farmer in need of financial assistance may first seek advice from a surveyor, land agent, valuer or some other similar professional to ensure he is taking advantage of

any schemes or subsidies, such as those administered by DEFRA's Rural Payments Agency, that may be available.

V5371 DEFRA are unable to supply opinions about the amount of work involved in particular farms or their likely annual returns. However, DMs may consult the DEFRA website (www.defra.gov.uk - Economics and Statistics page) for information about total farm income for the type of enterprise in question.

V5372 - V5379

Hotels, guest houses, bed and breakfast establishments

V5380 The normal self-employed earners rules for ESA should be considered when determining a claim involving a person running a hotel, guest house, lodging house or bed and breakfast establishment.

V5381 The DM should note that payments received for providing BL accommodation (see V5019) are not earnings¹.

1 ESA Regs 13, reg 82(2)(a)

Bars and restaurants in hotels, guest houses

V5382 Income from bars and restaurants where services are provided that are not included in the BL charge should be treated as earnings from self-employment. The DM should determine the assessment period and calculate the gross receipts and allowable expenses in the normal way.

V5383 - V5384

Local Exchange trading systems

V5385 LETS are associations that allow participants to exchange goods and services with others in the community.

V5386 LETS members list their offers of, and requests for, goods and services in a directory and then trade them using a system of credits. These can be given many different names such as

- bobbins
- brads
- newberries
- beacons
- acorns.

Participating in a local exchange trading system scheme

V5387 Participating in a LETS scheme should be regarded as work. The credits obtained are payment for the goods or services provided.

V5388 - V5389

Local exchange trading credits

V5390 Credits can be exchanged for goods and services in participating shops and businesses in much the same way as ordinary currency. Credits are considered taxable income by HMRC.

V5391 Credits can be treated as earnings depending on the circumstances of each case. Credits are **not** payments in kind.

V5392 If a person is gainfully employed as a S/E earner and receives credits as payment for services provided, those credits should be included in the gross receipts of the business.

V5393 The value of credits is equivalent to the number of credits awarded for the particular goods or services at the relevant exchange rate.

V5394 The DM should firstly find out whether the organisers of the scheme have equated the credits to a sterling equivalent. This may have been done for HMRC or VAT purposes. If so, that equivalent can be used as the exchange rate.

V5395 If a sterling equivalent is not available the DM should consider the question based on the circumstances of each case, including

1. how the transaction price is arrived at
2. whether the amount of credits earned varies with the type of work performed
3. what the exchange value of a credit is (what does it buy?)
4. whether the claimant works in the cash economy as well as in the LETS economy
5. what the average local rate of pay is for the particular work performed.

V5396 - V5399

Partnerships

V5400 Partners are similar to sole traders, except that ownership and control of the business is shared between two or more people.

V5401 People can enter into a partnership under an agreement that may be written, for example a deed of partnership, verbal or implied. A deed of partnership includes details of how any profit or loss is shared between the partners. In the absence of an agreement any profit should be shared equally among the partners¹.

1 Partnership Act 1890, s 24

V5402 The conditions under which a partnership is formed, operates or ends, are governed by the terms of a partnership deed or agreement together with the provisions of the relevant legislation¹. For most purposes, the terms of the deed or agreement prevail over the provisions of the Act. Where a deed or agreement exists, it becomes a legal document and its interpretation is a matter of law.

1 Partnership Act 1890

V5403 The legal status of a partnership should not be confused with that of a company, in that a partnership has no legal personality in law. At any one time the assets and liabilities of the partnership are (subject to the partnership deed or agreement and the relevant legislation¹), the joint and several assets and liabilities of the partners.

Note: Scots Law on the legal status of a partnership differs. In Scotland a partnership is a separate legal entity², distinct from the partners who carry out its business. DMs should refer any cases to DMA Leeds if further guidance is needed.

1 Partnership Act 1890; 2 s 4(2)

V5404 A partnership does not necessarily end when it ceases trading. It must be formally dissolved. The partnership deed or the legislation¹ may continue to impose rights and obligations on the parties following dissolution, providing further time for the winding up of its affairs. Further delays may result from legal challenges concerning the partnership's affairs.

1 Partnership Act 1890, s 38

V5405 - V5406

Calculation of a business partner's normal weekly earnings

V5407 Before calculating a partner's share of the net profit of the business, the DM should ensure that the gross receipts include the following for **all** partners

1. allowances from schemes to help with self-employment
2. personal drawings
3. expenses covering business and private use.

V5408 To calculate the normal weekly earnings of a business partner¹, the DM should determine the assessment period **and**

1. total the gross receipts of the whole business **and**
2. deduct any allowable expenses incurred by the whole business **and**

3. calculate the partner's share of the resulting "net profit"². The partner's share will be
 - 3.1 the share set out in the deed of partnership, if there is one **or**
 - 3.2 the shares agreed in an express or implied agreement between the partners **or**
 - 3.3 an equal share³ if neither 3.1 nor 3.2 apply, for example, if there are four partners, each partner's share is 25% **and**
4. deduct from 3. an amount for
 - 4.1 income tax **and**
 - 4.2 NI contributions
 calculated on the amount at 3. **and**
5. deduct half of any premium for a personal pension scheme.

1 ESA Regs 13, reg 83; 2 reg 83(3); 3 Partnership Act 1890, s 24

Example 1

Daniel is one of two partners in a building firm. He is in receipt of ESA. There is a deed of partnership that states that Daniel will receive 40% of the profits and the other partner 60%. The gross receipts for the business during the assessment period are £10,600. The allowable expenses are £5,400. The DM decides that Daniel's share of the profits is £2,080, calculated as follows

	£
Gross receipts	10,600
Less allowable expenses	5,400
	= 5,200
Divided by Daniel's share - 40%	= 2,080

The DM then deducts from £2,080 amounts for notional income tax and NI contributions and half of a premium for a personal pension scheme.

Example 2

Agnes and her brother are partners in a small pottery business. Agnes is in receipt of ESA. There is no deed of partnership or other agreement that profits should be shared unevenly. The gross receipts of the business during the assessment period are £8,750. Allowable expenses are £4,562. The DM determines that Agnes share of the net profit is £2,094, calculated as follows

	£
Gross receipts	8,750

Less allowable expenses 4,562

= 4,188

Divided by Agnes's = 2,094

share - 50%

The DM then deducts from £2,094 amounts for notional income tax and NI contributions. Agnes was not paying premiums for a personal pension scheme.

V5409

Salaried partners

V5410 A salaried partner may be an employed or S/E earner. A salaried partner may be a person who

1. receives a salary as remuneration and maybe a profit-related bonus. This type of salaried partner is an employed earner¹ **or**
2. may be paid a fixed salary not based on profit. But in addition is included in the partnership deed and is entitled to a share of the profits. This type of salaried partner is a S/E earner.

1 Ross v. Parkins (1875) LR 20 Eq 331 at 336

V5411 The DM should

1. consider the facts of each case **and**
2. examine the relationship between the person and the other parties

to decide if the salaried partner is a S/E earner.

V5412 If a S/E salaried partner receives a salary from the business in addition to a share of the business profit, the salary should not be deducted before arriving at the total net profit to be shared between partners. The DM should

1. calculate the chargeable income **and**
2. deduct tax, NI contributions and any premiums for a personal pension scheme

from the partner's share of the chargeable income.

V5413 - V5424

Renting out property as a business

V5425 If a person is letting properties that are not the home, the DM needs to consider if this is by way of a business¹.

V5426 A person who

1. has a single property that is not the home **and**
2. lets the property to tenants **and**
3. collects rents and does any repairs

is not conducting a business.

V5427 A person who joins with others to buy properties so that they can be let as flats or offices could be said to be conducting a business. The

1. number of properties involved **and**
2. long term intentions of the person

are factors that need to be considered.

V5428 If the DM determines that a person is conducting a business from renting out properties the rent is a gross receipt of the business.

Example

Michael has a partnership with another person in a business. The business has been set up to buy land and property for sale and let to tenants. Michael and his partner own a garage with two flats above it and two terraced houses on the same street.

The flats and houses are all let to tenants and Michael collects the rent and does the repairs and maintenance.

The DM determines that Michael is a S/E earner. The DM calculates Michael's earnings, the rental income is regarded as part of the gross receipts.

V5429 - V5439

Seasonally self-employed

V5440 If a S/E earner is seasonally S/E the DM should

1. consider the guidance at V5023 - V5026 **and**
2. determine if the S/E earner remains gainfully employed as a S/E earner.

Example

Shaun is S/E as an amusement arcade owner. The amusement arcade closed in October because the summer season had ended. Shaun stated that

1. he and his creditors regarded the business as a going concern. This is because he anticipated that his business would start up again in the following April when the holiday trade would re-commence

2. in April, when the holiday trade would re-commence he intends to start work again in the amusement arcade
3. he still undertakes some activities in the business. He is currently redecorating the arcade. He plans to renovate and maintain the electrics and make minor repairs before April. He also plans to update the alarm system. He is also looking to update some of the machines in the arcade
4. his accountant only submits figures from April to September each year. It is normal for him to only work between April and September each year.

The DM considers the guidance at V5023 - V5026 and decides, in this case, that Shaun remains gainfully employed as a S/E earner. As there had been no changes that had affected the normal pattern of trading the DM determines that the assessment period for the earnings should be one year.

V5441 - V5449

Sub-contractors

V5450 A sub-contractor is a S/E person who enters into a contract with another contractor to do a particular job, and is most commonly found in the construction industry.

Example

A firm of builders contract to build a house extension for Tony. They sub-contract the electrical work to Lee. Lee is a S/E sub-contractor and not an employee of either the building firm or Tony.

When Lee completes the work he moves to a different contract that may be for further work with the building firm or for a different contractor.

V5451 If a S/E sub-contractor claims ESA the DM should consider

1. the guidance at V5023 - V5026 **and**
2. if the S/E sub-contractor remains gainfully employed as a S/E earner.

Example

Bruce is a S/E electrician. He sub-contracts for other contractors. Bruce has just finished one contract and work on the next contract is not due to start for another couple of weeks. Bruce states that

1. he still regards himself as S/E and his business as a going concern but has no work at the moment
2. there are good prospects of work in the future
3. he is advertising for work all of the time and further contracts are in the pipeline

4. there have been other occasions where there has been a break between contracts.

The DM considers the guidance at V5023 - V5026 and determines, in this case, that Bruce remains gainfully employed as a S/E earner.

Actors and entertainers

V5452 DMs must consider claims from actors and other entertainers in the same way as any other claimants. Each case must be decided on its own merits. The DM should decide whether a claimant's earnings are from employment as a S/E earner or employment as an employed earner (see ADM Chapter V4 for the meaning of employed earner).

V5453 In general, because of the nature of an actor's or entertainer's employment, the DM may find that their earnings are from employment as a S/E earner. However, it is possible for an entertainer whose general pattern of employment is that of a S/E earner, to have periods of employment as an employed earner at the same time as his overall self-employment.

V5454 The fact that an actor or entertainer has periods of employment during which class 1 NI contributions are payable is not conclusive when deciding whether that employment is as an employed earner. It is for the DM deciding the claim to ESA to decide whether earnings are from employment as an employed earner or from self-employment. Where an entertainer whose general pattern of employment is that of a S/E earner contends that certain engagements were as an employed earner and that class 1 contributions were paid it will be for the DM to decide whether the claimant was employed under a contract of service as an employed earner or otherwise.

Example 1

Laura is an actress. Her acting engagements are sporadic, and she is not currently working due to a broken leg. She continues to look for work and remains on her agent's books. She has been booked for some future engagements, but nothing substantial, and has not worked for several weeks. She says that she could find more substantial acting work at any time, that being the nature of work. In the year prior to the current claim, the claimant has had a number of engagements in advertising and the theatre as well as three separate, short term, engagement with the BBC to appear in three separate dramatic productions. Her most substantial earnings were derived from these engagements with the BBC. She states that she was actually employed by the BBC under a contract of service as an employed earner and says that the fact that she paid class 1 NI contributions supports this contention. As such she argues that her earnings from the BBC should not be included when working out her earnings from self-employment. The DM

1. decides that the claimant is gainfully employed as a S/E earner (see V5023 - V5026)
2. considers the terms under which the claimant was engaged by the BBC and decides that as she was engaged to perform a specific role on particular occasions for a fixed fee, she was employed under a contract for services as a self-employed earner and not under a contract of service as an employed earner. Therefore the earnings from the BBC fell to be taken into account with her other earnings from self-employment
3. decides that the sporadic nature of the employment is the normal pattern of the business and calculates her average weekly earnings over the preceding year.

Example 2

Craig is a dancer. He is unable to work due to a serious illness. He states that he is usually S/E, carrying out one-off engagements in the theatre. However, unusually, he was engaged by a dance company for a fixed 26 weeks period during the previous year. He contends that during this period he was engaged as an employed earner, employed under a contract of service, and paid class 1 NI contributions.

The DM decides that Craig's employment with the dance company was under a contract of service as an employed earner for the 26 weeks when he was engaged by the dance company, and as such the earnings from that employment are not included in the calculation of the claimant's earnings as a S/E earner.

Share fishermen

V5455 A share fisherman is¹

1. a person who
 - 1.1 usually works in the fishing industry **and**
 - 1.2 is S/E **and**
 - 1.3 is the master or a crew member of a British fishing boat crewed by more than one person **and**
 - 1.4 is paid for that work wholly or partly by a share of the profits or gross earnings of the fishing boat **or**
2. a person who
 - 2.1 was a person who worked as in 1., but has permanently stopped such work because of age or ill health **and**
 - 2.2 usually works
 - 2.2.a ashore in GB **and**

2.2.b as S/E **and**

2.2.c making or mending any gear belonging to a British fishing boat or performing other services that help, or are connected with, a British fishing boat **and**

2.3 is paid for that work wholly or partly by a share of the profits or gross earnings of the fishing boat **and**

2.4 has not ceased to usually work as described in **2.2**.

1 ESA Regs 13, reg 83(1)(b); SS (Mariners' Benefits) Regs, reg 1(2)

V5456 The master and all the members of the crew of a fishing boat are within the definition at V5455 1., This includes those who do a specialist job, such as an engineman, cook or firefighter, as long as they are paid at least partly by a share in the earnings of the fishing boat¹.

1 R(U) 10/51

V5457 A share fisherman is a S/E earner. One difference between a

1. share fisherman **and**
2. business partner

is that the share fisherman pays a higher rate of Class 2 contributions (see Appendix 2 to this chapter). Class 4 liability is the same (see Appendix 2 to this chapter).

V5458 Earnings should only be taken into account when a person is a S/E earner. A S/E earner is a person who is gainfully employed

1. in GB **and**
2. in employment that is not employed earner's employment

Note: A share fisherman may also be employed in another occupation as an employed earner. This does stop that share fisherman being S/E.

Claims from share fishermen

V5459 The rules for calculating the earnings of a share fisherman are the same as for any other S/E claimant who is in partnership with another person. DMs should contact DMA Leeds if further guidance on dealing with claims from share fisherman is required.

V5460 - V5999

Appendix 1

Notional deductions for income tax

Main income tax allowances

1. The main income tax allowances are as follows

		11/12	12/13	13/14	14/15	15/16	16/17	17/18
		£	£	£	£	£	£	£
Additional personal		-	-	-	-	-	-	-
Personal	under 65	7,475	8,105	9,440	10,000	10,600	11,000	11,500
Personal	65 - 74	9,940	10,500	10,500	10,500	10,600	11,000	11,500
Personal	75 & over	10,090	10,660	10,660	10,660	10,660	11,000	11,000
Married couple	under 65	-	-	-	-	-	-	-
Married couple	65 - 74	-	-	-	-	-	-	-
Married couple	75 & over	7,295	7,705	7,915	8,165	8,355	8,355	8,445
		18/19	19/20					
		£	£					
Additional personal		-	-					
Personal	under 65	11,850	12,500					
Personal	65 - 74	11,850	12,500					
Personal	75 & over	11,850	12,500					
Married couple	under 65	-	-					
Married couple	65 - 74	-	-					
Married couple	75 & over	-	-					

Basic rates of tax

2. Income tax is payable on taxable income

	£	
11/12	1 - 35,000	at basic rate of 20%
12/13	1 - 34,370	at basic rate of 20%
13/14	1 - 32,010	at basic rate of 20%
14/15	1 - 31,865	at basic rate of 20%
15/16	1 - 31,785	at basic rate of 20%
16/17	1 - 32,000	At basic rate of 20%
17/18	1 - 33,500	At basic rate of 20%
18/19	1 - 34,500	At basic rate of 20%
19/20	1 - 37,500	At basic rate of 20%

Appendix 2

Notional deductions for National Insurance contributions

Class 1 contributions

1. The Class 1 NI contribution for any week or month is based on the percentage rate appropriate to the band in which the estimated gross earnings fall.

2.	Earnings Bands 11/12	Percentage rates	Earnings Limits 11/12
	Earnings		LEL
	1. up to LEL	NIL	weekly £102
	2. LEL to UEL	12% of earnings that exceed LEL up to UEL	monthly £442
			UEL
			weekly £817
			monthly £3,540

Primary threshold

No contributions are payable on weekly earnings of £139 or less or monthly earnings of £602 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £139.01 and £817 per week and at 2% for earnings above £817 per week.

3.	Earnings Bands 12/13	Percentage rates	Earnings Limits 12/13
	Earnings		LEL
	1. up to LEL	NIL	weekly £107
	2. LEL to UEL	12% of earnings that exceed LEL up to UEL	monthly £464
			UEL
			weekly £817
			monthly £3,540

Primary threshold

No contributions are payable on weekly earnings of £146 or less or monthly earnings of £634 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £146.01 and £817.00 per week and at 2% for earnings above £817 per week.

4.	Earnings Bands 13/14		Earnings Limits 13/14
	Earnings	Percentage rates	LEL
	1. up to LEL	NIL	weekly £109
	2. LEL to UEL	12% of earnings that exceed LEL up to UEL	monthly £472
			UEL
			weekly £797
			monthly £3,453

Primary threshold

No contributions are payable on weekly earnings of £149 or less or monthly earnings of £645 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £149.01 and £797 per week and at 2% for earnings above £797 per week.

5.	Earnings Bands 14/15		Earnings Limits 14/15
	Earnings	Percentage rates	LEL
	1. up to LEL	NIL	weekly £111
	2. LEL to UEL	12% of earnings that exceed LEL up to UEL	monthly £481
			UEL
			weekly £805
			monthly £3488

Primary threshold

No contributions are payable on weekly earnings of £153 or less or monthly earnings of £663 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £153.01 and £805 per week and at 2% for earnings above £805 per week.

6. Earnings Bands		Earnings Limits
15/16		15/16
Earnings	Percentage rates	LEL
1. up to LEL	NIL	Weekly £112
2. LEL to UEL	12% of earnings that exceed LEL up to UEL	Monthly £486
		UEL
		Weekly £815
		Monthly £3532

Primary threshold

No contributions are payable on weekly earnings of £155 or less or monthly earnings of £672 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £155.01 and £815 per week and at 2% for earnings above £815 per week.

7. Earnings Bands		Earnings Limits
16/17		16/17
Earnings	Percentage rates	LEL
1. up to LEL	NIL	Weekly £112
2. LEL to UEL	12% of earnings that exceed LEL up to UEL	Monthly £486
		UEL
		Weekly £827
		Monthly £3584

Primary threshold

No contributions are payable on weekly earnings of £155 or less or monthly earnings of £672 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £155.01 and £827 per week and at 2% for earnings above £827 per week.

8. Earnings Bands		Earnings Limits
17/18		17/18
Earnings	Percentage rates	LEL
1. up to LEL	NIL	Weekly £113
2. LEL to UEL	12% of earnings that exceed LEL up to UEL	Monthly £490
		UEL
		Weekly £866
		Monthly £3753

Primary threshold

No contributions are payable on weekly earnings of £157 or less or monthly earnings of £681 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £157.01 and £866 per week and at 2% for earnings above £866 per week.

9. Earnings Bands		Earnings Limits
18/19		18/19
Earnings	Percentage rates	LEL
1. up to LEL	NIL	Weekly £116
2. LEL to UEL	12% of earnings that exceed LEL up to UEL	Monthly £490
		UEL
		Weekly £892
		Monthly £3863

Primary threshold

No contributions are payable on weekly earnings of £162 or less or monthly earnings of £702 or less. Otherwise contributions are still payable at a rate of 12% for earnings between £162.01 and £892 per week and at 2% for earnings above £892 per week.

Class 2 contributions

10. The weekly rate of Class 2 contributions are as follows

	£	£	£	£	£	£	£
	11/12	12/13	13/14	14/15	15/16	16/17	17/18
	£	£	£	£	£	£	£
Ordinary Class 2 rate	2.50	2.65	2.70	2.75	2.80	2.80	2.85
Share fisherman rate	3.15	3.30	3.35	3.40	3.40	3.45	3.50
.							
	18/19	19/20					
	£	£					
Ordinary Class 2 rate	2.95	3.00					
Share fisherman rate	3.60	3.65					

Small earnings exception/small profits threshold

11. The rates of the small earnings exception are as follows.

	11/12	12/13	13/14	14/15	15/16	16/17	17/18
	£	£	£	£	£	£	£
Earnings limit	5,315	5,595	5,725	5,885	5,965	5,965	6,025
.							
	18/19	19/20					
	£	£					
Earnings limit	6,205	6,365					

Class 4 contributions

12. The weekly rates of Class 4 contributions are as follows.

	11/12	12/13	13/14	14/15	15/16	16/17	17/18
	£						
Lower level	7,225	7,605	7,755	7,956	8,060	8,060	8,164
Higher level	42,475	42,475	41,450	41,865	42,385	43,000	45,000
Percent age rate	9% of £7,225 to £42,475 per year, 2% above £42,475	9% of £7,605 to £42,475 per year, 2% above £42,475	9% of £7,755 to £41,450 per year, 2% above £42,450	9% of £7,956 to £41,865 per year, 2% above £41,865	9% of £8,060 to £42,385 per year, 2% above £42,385	9% of £8,060 to £43,000 per year, 2% above £43,000	9% of £8,614 to £45,000 per year, 2% above £45,000
	18/19	19/20					
	£	£					
Lower level	8,424	8,632					
Higher level	46,350	50,000					
Percent age rate	9% of £8,424 to £46,350 per year, 2% above £46,350	9% of £8,632 to £50,000 per year, 2% above £50,000					

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