

SOCIAL SECURITY
ADVISORY COMMITTEE

**Social security provision and the self-
employed**

**A study by the Social Security Advisory Committee
Occasional Paper No. 13**

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About this report

This project was conducted as part of the Social Security Advisory Committee's (SSAC's) Independent Work Programme, under which the Committee investigates pertinent issues relating to the operation of the benefits system.

We would like to thank the individuals and organisations that provided their views on this issue, including at a round-table event on self-employment in April 2014, and at the SSAC stakeholder event in May 2014.

We are also grateful for the assistance of our Policy Analyst, James Evans, who prepared the paper for us and to officials from the Department for Work and Pensions who provided factual information. However, the views expressed and recommendations reached in the paper are solely those of the Committee.

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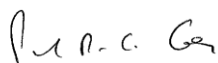
Foreword

The relationship between self-employment and social security has long been problematic, contested and complex. From the origins of insurance based social security in the UK the self-employed have necessarily been treated as a 'special case'. Similarly in other countries, there has been the development of special, and complicated, arrangements to mitigate the risks the self employed face while recognising the contributions they make to wider social and economic well-being.

The Committee is alert to the increased significance of self-employment as an important part of a dynamic economy recovering from recession. The changing composition of the self-employed sector is evidenced by growing numbers in aggregate and, in particular, by increased numbers (and percentages) of women and those aged over 50 years. We also note the increasing disparity of earnings within the sector, as between men and women and between those working in London and those working elsewhere; these income dynamics are further characterised by a growth in low income self-employment and greater overall income volatility.

SSAC welcomes the important contribution that the self-employed make to economic recovery, innovation and competitiveness. We also accept that the social security system should always seek to support and not impede economic activity; social security should mitigate risk and support those who wish to become entrepreneurs. Equally, those who make the transition to successful self-employment should be reasonably expected to support those who might wish to make a similar journey or indeed those who, for whatever reason, having embarked on the journey find that they cannot succeed. Striking an appropriate balance between *de minimus* burden and *de maximus* risk mitigation is the challenge policy makers face. Through this study we hope to identify some of the dilemmas and ongoing questions that need to be addressed.

We examine socio-economic trends in self-employment; we review the evolution of social security provision for, and contributions made by, the self-employed; we look in some detail at the impact of Universal Credit on this group. We note the permeable boundary between employment and self-employment and query the existence of incentives to engage in 'false' self-employment. We conclude by calling for a Government examination of the comparative levels of social security coverage between employees and self-employed with a view to ensuring that on a level playing field, all workers both contribute to and benefit from social security in ways which fairly reflect their circumstances. Secondly, we recommend that Government establish a working group to urgently address a number of concerns about the policy and roll-out of Universal Credit for the self-employed.



Paul Gray
Chair, SSAC

1. Introduction

Self-employment in the UK has been increasing since the turn of the century, having risen from 12 per cent of all employment in 2000, to 15 per cent by the start of 2014. It is therefore more important than ever that the social security system accounts for this group and that it can make a positive contribution towards their well-being when required.

But it is not only the self-employed who stand to gain from a social security system designed to meet their needs. The International Social Security Association has identified a range of related benefits including impacts on social cohesion (enhanced where the greatest number of people are covered against risks), and equity (whereby everyone with sufficient means should contribute to social security).¹

It has in the past seemed that the self-employed have not been held in sharp focus in the design of the social security system. This is in contrast to the initial design for social security proposed in the Beveridge Report, which clearly considered the particular needs of this group, and the ability of administrators to meet them. The social security system has changed significantly from that devised by Beveridge, as have the self-employed, who in 1942 were characterised by Beveridge as ‘small shopkeepers, crofters, fishermen, hawkers, outworkers’, but in today’s labour market cover a full range of occupations including farmers, IT consultants, salespeople, construction workers and accountants to name but a few.²

This report first looks at current trends in self-employment in the UK. It then outlines the National Insurance contributions required of the self-employed, their historical context, and the entitlements to contributory benefits which are made available in return. Further context is provided with a comparison of social security coverage for the self-employed across Europe. The report then considers two pertinent issues: the incentives inherent in the present system to engage in ‘false self-employment’, and specific concerns about the policy and application of Universal Credit for the self-employed. Both issues would benefit from an in-depth study of relevant regulations and guidance not possible in this report, and we therefore recommend further work is undertaken by the Government, to ensure the future social security system is developed with the self-employed in full view.

¹ International Social Security Association (2012), *Handbook on the extension of social security coverage to the self-employed*. Available at:

<http://www.issa.int/details?uuid=c6aa1d76-b16a-452d-b4ab-ff3b1ca87d93>

² William Beveridge (1942), *Social insurance and allied services*. Cmd 6404, Paragraph 119.

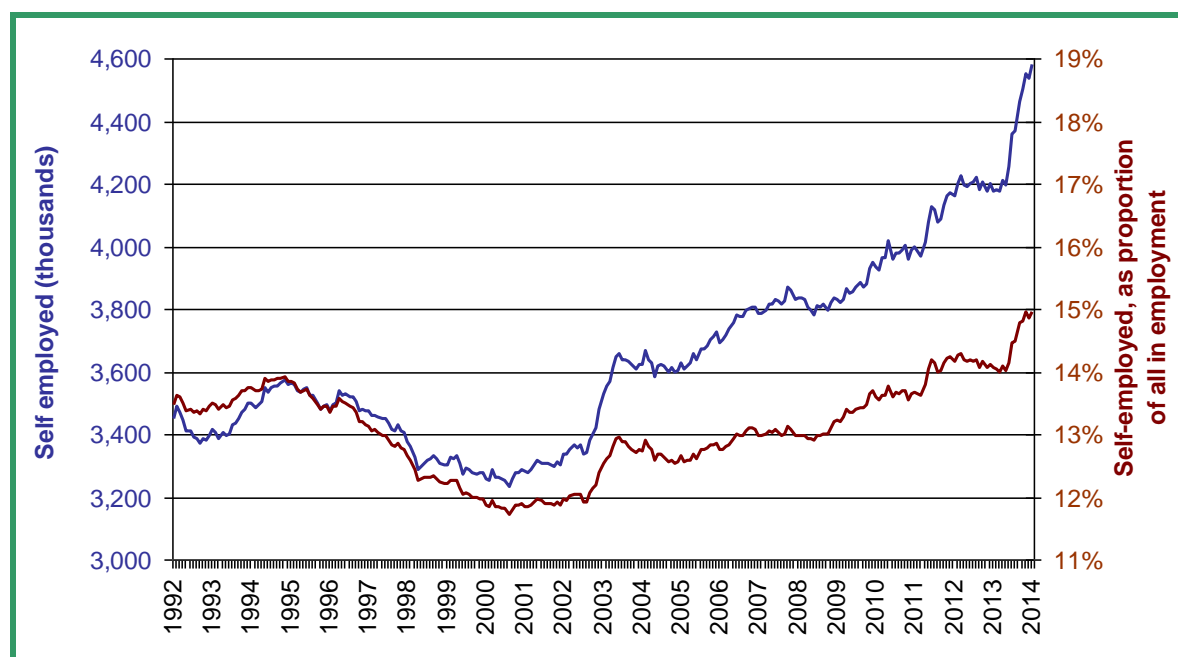
2. Current trends in self-employment

The following chapter draws together published statistics and the findings of reports on: the overall level of self-employment, possible causes of observed trends, trends among sub-groups of the self-employed and across Europe, incomes from self-employment, and pension saving among the self-employed.

2.1 The overall level of self-employment

The latest labour market statistics from the Office for National Statistics (ONS) show that 84 per cent of workers consider themselves to be employees.³ At the same time, 15 per cent of workers consider themselves to be self-employed.⁴ This proportion has increased since the early 2000s (after falling steadily from the mid-90s), as shown in red in Chart 1 below. However this growth has not been consistent, with periods of rapid increases in the proportion of the workforce who are self-employed followed by periods of stagnation or small proportional falls. Thus by the start of the recession in 2008, the proportion of the workforce self-employed was comparable with that of the late 1990s. Since then the proportion of the workforce self-employed has continued its upward trend.

Chart 1: Number of people self-employed, UK (seasonally adjusted)



Source: analysis of ONS labour market statistics summary tables.

The absolute number of self-employed people reached a low of 3.2m in Oct-Dec 2000, before increasing to 4.6m for the period March-May 2014 (the latest available period). This increase of 42 per cent compares to an increase of 6 per cent for employees (in the same period).

³ Analysis of data from ONS (2014), *Labour market statistics summary data tables*. Published on 16 July 2014. Available at:

<http://www.ons.gov.uk/ons/taxonomy/index.html?nsc1=Labour+Market#tab-data-tables>

⁴ The remaining 1% categorise themselves as either 'unpaid family workers' or are participating in 'Government supported training & employment programmes'.

2.2 Possible causes for the increase in self-employment

Whilst we can identify trends in employment patterns, ascertaining the causes leading to these patterns is more difficult. As the Organisation for Economic Co-operation and Development (OECD) explain:

Self-employment may be seen either as a survival strategy for those who cannot find any other means of earning an income or as evidence of entrepreneurship and a desire to be one's own boss.⁵

OECD

These two different experiences of self-employment, as a 'last resort' and as a 'lifestyle choice', are reflected in the current public debate around the rise in self-employment. The Trades Union Congress (TUC) in particular has focussed on those who may become self-employed as a 'last resort', whilst The Royal Society of Arts, Manufactures and Commerce (RSA) have focussed more on those who are making a positive choice to become self-employed as a 'lifestyle choice'.

The TUC is concerned that many people are only taking this kind of work because they are unable to find good quality employee jobs which provide the stable employment they really want.⁶

TUC

... we should actually celebrate the rise of self-employment. It is a sign of a healthier economy and greater entrepreneurial spirit. It allows people to be more autonomous and turn their own ideas and vision for themselves and others into reality ...⁷

RSA

⁵ OECD (2006), *Women and men in OECD countries*. Available at: <http://www.oecd.org/std/37962502.pdf>.

⁶ TUC press release (2014), *More than two in five new jobs created since mid-2010 have been self-employed*. Available at: <http://www.tuc.org.uk/economic-issues/economic-analysis/labour-market/labour-market-and-economic-reports/more-two-five-new>.

⁷ RSA press release (2014), *The evidence proves self-employment is great. Celebrate it!* Available at: http://www.rsablogs.org.uk/2014/adam-lent/evidence-proves-selfemployment-great-celebrate/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+rsaprojects+%28RSA+blogs%29

But these positions are not the polar opposites they can be presented as, with most commentators and analysts recognising the substantial diversity of experience among those who find themselves self-employed and that a particularly wide range of personal situations are grouped together into the category of 'self-employed'. This is a point made by the Low Incomes Tax Reform Group:

There are some 4 million self-employed people in the UK. The self-employed are a diverse body of people, ranging from budding entrepreneurs to those with little or no business acumen, and all sorts in between. Self-employment can also be an important option for people for whom traditional employment may not be suitable (eg for health reasons), or where employment is scarce. Self-employment can be a long term career choice or it can be a short-term option to tide someone over until the next employment comes along. It can be full-time or part-time, or any variable – some will invest virtually all their time in their business, while others may work only a few hours here and there.⁸

Low Incomes Tax Reform Group

It is likely that the rise in self-employment is occurring across these different groups, and it is therefore important that public debate and public policy takes full account of this diversity.

Further explanations for the rise in self-employment are structural. For example, it may be that technological progress (such as the internet) has increased the ease with which self-employment can be undertaken, including work undertaken from the home.

A survey carried out for the RSA found that:

... over a third of self-employed people would not have been able to start their firm at all without recent advances in technology such as the internet, while another third said they could but it would have been less successful.⁹

RSA

⁸ Low Incomes Tax Reform Group (2011), *Welfare Reform Bill: memorandum submitted by the Low Incomes Tax Reform Group*. Available at:

<http://www.publications.parliament.uk/pa/cm201011/cmpublic/welfare/memo/wr20.htm>

⁹ RSA (2014), *Salvation in a start-up? The origins and nature of the self-employment boom*. Available at: http://www.thersa.org/_data/assets/pdf_file/0004/1543855/RSA_Salvation-in-a-start-up-2014.pdf

In addition, de-industrialisation and the long-term shift in the economy away from manufacturing and towards services have lessened the need for large capital investments. This creates opportunities for the self-employed, who are better able to compete in industries which do not require large amounts of up-front investment, for example in machinery. A report from the Chartered Institute of Personnel and Development found that in 1961, 36 per cent of employment was in manufacturing and 49 per cent was in services. By 2011, 8 per cent were employed in manufacturing and 81 per cent in services.¹⁰

The Government's 'New Enterprise Allowance' may also have contributed, in a small way, to the rise in self-employment, by providing financial and business support for benefit claimants seeking to start a business.¹¹

In recent discussions the Bank of England Monetary Policy Committee have also considered the increase in self-employment and its likely causes, concluding that the trend appeared to be at least partly structural but also recognising the diversity of drivers.

It was possible that some of the increase had come about in reaction to benefit caps, changes in pension entitlements and rules surrounding access to in-work benefits. A key question was whether the amount of slack in the labour market was understated by measured unemployment, as might be the case if many of the self-employed were underemployed and searching for work as employees. There was some evidence against this. First, part of the rise in self-employment appeared to be a continuation of a longer-term secular trend, rather than a cyclical response to a lack of other employment opportunities. Consistent with that, higher self-employment did not appear to have been associated with inflows of people recently made redundant. Second, survey evidence suggested that the self-employed were only slightly more likely to be looking for another job than were employees. For some, self-employment might have been chosen as an alternative to retirement, rather than as an alternative to employment. Nevertheless, it was possible that some of the self-employed were underemployed and would be more productive as employees were more jobs to become available. Members of the Committee held a range of views about the extent to which self-employment represented a form of labour market slack.¹²

The Bank of England, Monetary Policy Committee

¹⁰ CIPD (2013), *Megatrends: the trends shaping work and working lives*. Available at:

<http://www.cipd.co.uk/hr-resources/research/megatrends-trends-shaping-work-lives.aspx>

¹¹ The latest statistics (published 17 June 2014) show that between April 2011 and March 2014, there have been 93,880 starts with a New Enterprise Allowance mentor, and 46,000 starts to the New Enterprise Allowance weekly allowance. In the same period the overall level of self employment has increased by over 500,000, with the number of new entrants to self-employment being significantly higher. (Data taken from DWP (2014), *Pre-Work Programme support: New Enterprise Allowance, June 2014*, and from analysis of ONS labour market statistics summary tables).

¹² Bank of England, Monetary Policy Committee (2014), *Minutes of the Monetary Policy Committee Meeting: 9 April 2014*. Available at:

<http://www.bankofengland.co.uk/publications/minutes/Documents/mpc/pdf/2014/mpc1404.pdf>

2.3 Trends among sub-groups of the self employed

Within the overall rise in self-employment there are a number of notable trends for particular groups.

Older workers

The previous quote from the Bank of England suggests some people may have entered self-employment as an alternative to retirement rather than employment. This finding accords with TUC analysis of the Labour Force Survey which showed that half of the increase in self-employment since mid-2010 is accounted for by those aged 50 plus.

Workers aged 50 plus account for half the increase in self-employment, with self-employed workers aged 65 and over the fastest growing group in the labour market (increasing by 29 per cent since the end of 2010).¹³

TUC

This trend can be seen from Table 1, with those aged over 50 accounting for more than half of the increase in total self-employment since Oct-Dec 2001 (the earliest comparable figures). This is caused both by an increasing proportion of the age group in self-employment (a bigger proportional increase than for other age groups), and by an underlying increase in the population of this group.

As suggested by the previous quote from the Bank of England MPC, the increase in self-employment among older people may reflect a move away from retirement, rather than away from employment.

Gender

Since 1992, the number of self-employed men has increased by 580,000, slightly more than the increase of 550,000 for women. However, since there were initially considerably more self-employed men than women, these relative increases have resulted in an increase in the proportion of the total self-employed population who are women. This can be seen in Chart 2.

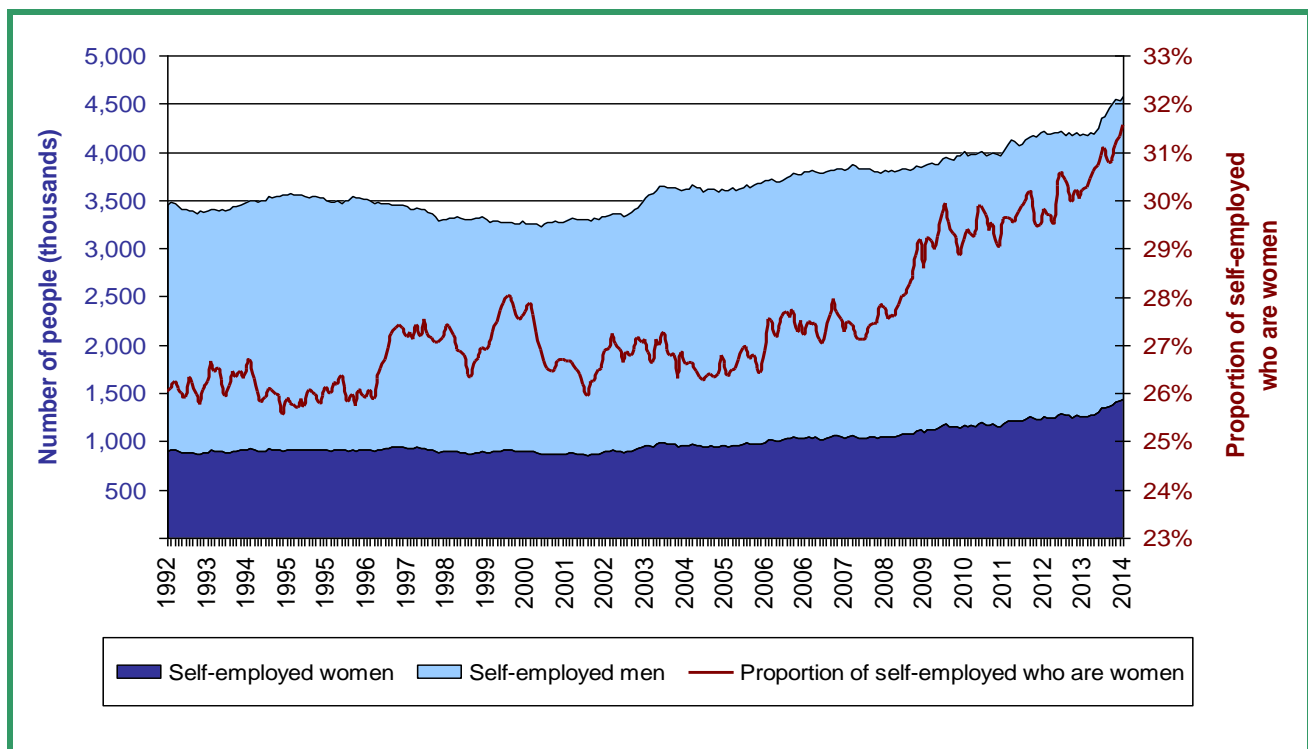
¹³ TUC press release (2014), *More than two in five new jobs created since mid-2010 have been self-employed*. Available at: <http://www.tuc.org.uk/economic-issues/economic-analysis/labour-market/labour-market-and-economic-reports/more-two-five-new>.

Table 1: Self-employment, split by age-group

	Age group						Total
	16-17	18-24	25-34	35-49	50-64	65+	
Self employed, Jan - Mar 2014 (thousands)	4	181	775	1,682	1,490	423	4,554
Change in self-employed, 'Jul - Sept 2001' to 'Jan - Mar 2014' (thousands)	-4	+78	+192	+312	+387	+261	+1,227
Proportion of population self-employed, Jan - Mar 2014	0.3	3.2	8.8	13.1	12.9	3.9	8.9
Change in the proportion of population self-employed, 'Jul - Sept 2001' to 'Jan - Mar 2014'	-0.2	+1.1	+1.8	+2.2	+2.1	+2.1	+3.2
Share of overall increase in self-employment, 'Jul-Sept 2001' to 'Jan - Mar 2014'	0%	6%	16%	25%	32%	21%	100%

Analysis of data from the Office for National Statistics (ONS)¹⁴

Chart 2: Number of self-employed men and women, UK (seasonally adjusted)



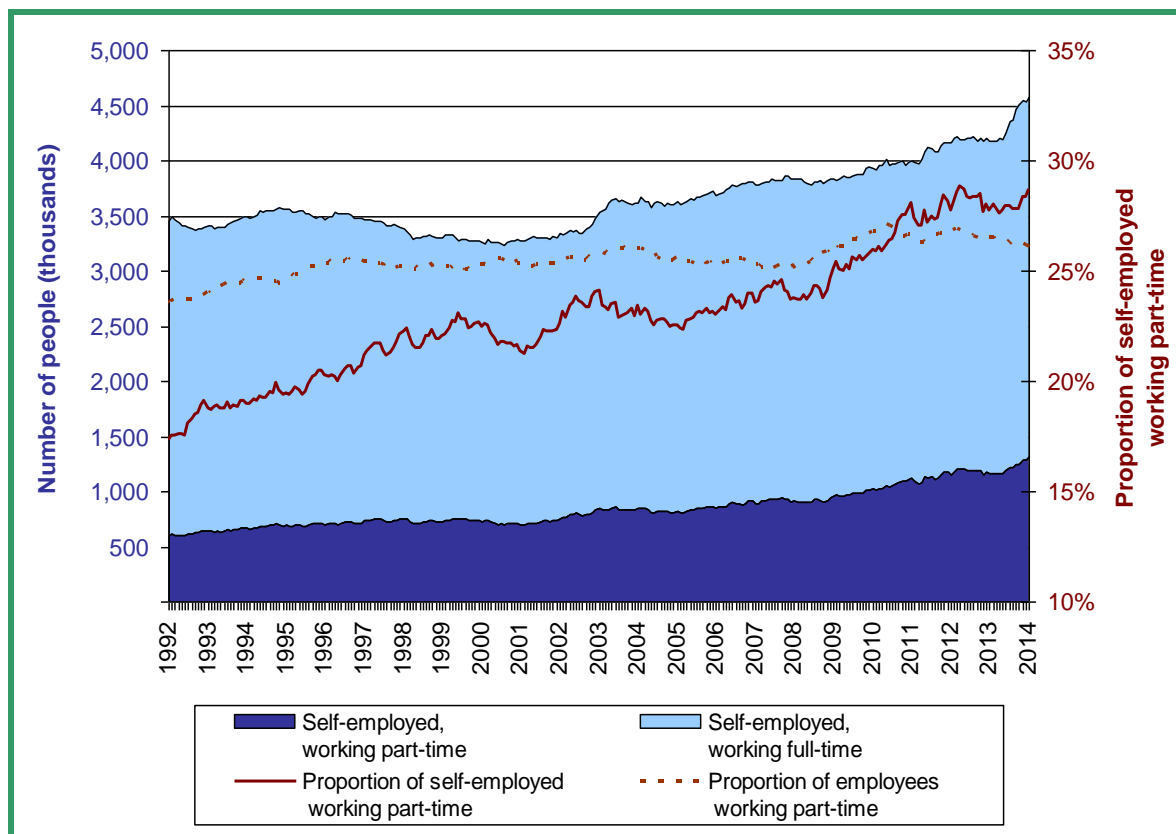
Source: analysis of ONS labour market statistics summary tables.

¹⁴ Data from ONS (2014), *Self-employment and employees, by age 2001-2014*. Released 13 June 2014.

Part-time workers

Chart 3 shows a steady increase in the proportion of self-employed working part time, with the latest statistics (for the period Nov 2013 – Jan 2014) showing this group to encompass 29 per cent of all self-employed.¹⁵ The proportion is much higher for women (54 per cent) than for men (17 per cent). Chart 3 also shows part-time work increasing for employees, though this increase is not as pronounced as it is for the self-employed. At the end of 2010 the proportion of the self-employed who worked part-time overtook the proportion of employees working part-time.

Chart 3: Number of self-employed people working full- and part-time, UK (seasonally adjusted)



Source: analysis of ONS labour market statistics summary tables.

2.4 Trends in self-employment across Europe

Growth in self-employment in the United Kingdom reflects broader trends to be found across the European Union. The most recent overview and analysis of self-employment in Europe was published in 2010. At that time a survey of European public opinion found that 45 per cent of all EU citizens would like to be self-employed and 49 per cent would prefer to be an employee. Men were more likely to express preference for self-employment than women. Similarly young people were more likely to prefer self-employment than were older people.

¹⁵ This is based on self-classification of part-time / full-time by respondents to the Labour Force Survey.

The results of the survey show that self-fulfilment, independence and free choice of place and time of working are the main reasons to think about starting one's own business, while citizens from the newer Member States also appreciate the prospects of better income.¹⁶

Advisory Group on Tax and Social Welfare (Ireland)

Across Europe self-employment is of considerable significance to the wider economy and as an expression of economic activity; over 99 per cent of all companies are 'Small or Medium Enterprises' and these provide over two-thirds of all employment. According to the definition of self-employment used in the Labour Force Survey (i.e. own business, making profit, in operation or being set up, employer or alone) there were 32.5 million self-employed in the EU in 2009, representing 14.9 per cent of total employment at that time.¹⁷ With the onset of the financial crisis in 2008 there was a significant contraction in the numbers of self-employed but within 18 months there was renewed growth – broadly inline with a growth in the unemployment rate.

A strictly comparable presentation of data across the EU is not possible due to differences in definition. However, self-employment is highest in Greece, Italy, Portugal and Romania and lowest in Luxembourg, Estonia, Denmark and Lithuania. Some indications can be given on a country by country basis: in Germany, for example, it is reported that there has been an increase in the number of self-employed as a result of assistance given to unemployed people, such that 20 per cent of all business founders in 2009 had previously been unemployed.¹⁸ Self-employment is more common in the southern EU states due to the predominance of agriculture. It can approach 30 per cent of total employment in Greece, and is almost as high in Bulgaria, Cyprus, Italy, Portugal and Romania.

2.5 Trends in entering and leaving self-employment

A recent report on self-employment from the *Resolution Foundation* looked at whether the increase in self-employment was being caused by an increase in the rate of people entering self-employment, or a decrease in the rate of people leaving self-employment. It found that 72 per cent of the increase in self employment was accounted for by an increase in entrants, with 28 per cent due to a decrease in exits. By comparison, the decrease in exits was not observed to the same extent for employees.

¹⁶ Advisory Group on Tax and Social Welfare (Ireland) (2013), *Third report: extending Social Insurance Coverage for the Self-Employed*. Available at: <http://www.welfare.ie/en/downloads/Third-Report-Extending-Social-Insurance-Coverage-for-the-Self-Employed.pdf>

¹⁷ European Commission (2010), *European Employment Observatory Review: self-employment in Europe 2010*. Available at: ec.europa.eu/social/BlobServlet?docId=6137&langId=en

¹⁸ Ibid.

[The] decline in the rate at which people leave self-employment accounts for over a quarter (28 per cent) of overall self-employment growth over the post-recession period, with a rise in people becoming self-employed accounting for the remaining three quarters (72 per cent). This declining out-flow rate is not seen to the same extent for employees, for whom out-flows have remained relatively flat over the pre- and post-crisis periods. ... In other words, the recent increase in employee numbers is much more strongly composed of in-flows (as might be expected following a recession) than the increase in the self-employed.¹⁹

Resolution Foundation

A report from the Institute for Social & Economic Research identified characteristics associated with people entering and exiting self-employment across a number of European countries.²⁰

The report found that, within Britain, the factors most associated with entering self-employment were: being unemployed, being a professional, and duration of unemployment. That being unemployed and being a professional are both associated with a higher probability of entering self-employment points to the wide range of experiences that are grouped together under 'self-employment'.

The same study found that the factors most associated with exiting self-employment (within Britain) were: unemployment rate, being aged 30-44, and having entered self-employment from unemployment.

2.6 Self-employed incomes

Table 2 shows average incomes of self-employed people split by region. This shows incomes being significantly higher for men in London, the South East, the East of England and, to a lesser extent, Scotland. Whilst these trends are also true for women, the disparity in wages across regions is less pronounced. This likely reflects a different mix of roles being undertaken in and around London, and especially by men.

¹⁹ Resolution Foundation (2014), *Just the job – or a working compromise?* Available at: http://www.resolutionfoundation.org/media/media/downloads/Just_the_job_-_or_a_working_compromise_1.pdf.

²⁰ Institute for Social & Economic Research (2011), *Self-employment flows and persistence: a European comparative analysis*. Available at: <https://www.iser.essex.ac.uk/publications/working-papers/iser/2011-26>

Table 2: Average self-employed income by region

<i>Region</i>	<i>Male (£)</i>	<i>Female (£)</i>
North East	12,700	8,230
North West and Merseyside	13,900	8,950
Yorkshire and the Humber	13,700	8,940
East Midlands	13,800	8,670
West Midlands	13,100	8,850
East of England	18,200	9,740
London	25,700	12,400
South East	19,100	10,000
South West	13,900	8,370
Wales	12,400	8,060
Scotland	16,500	11,100
Northern Ireland	12,000	9,300
United Kingdom	17,000	9,800

Source: analysis of data from the Survey of Personal Incomes 2011-12. Comparable data is not readily available for the employed.²¹

These income disparities between sexes are not a new phenomenon. A Joseph Rowntree Foundation report from 1994 found that men were over-represented among the high-earning self-employed, who tended to work in sectors such as banking, finance and business services (all more likely to be in London and surrounding areas), as well as construction.²²

Although the precise extent is uncertain, the average income of the self-employed has been found to be decreasing. This in-part reflects the changing composition of self-employment, with increases in part-time self-employment and female self-employment both likely to reduce the average income of the group. By analysing data from the Family Resources Survey (FRS), the RSA found that:

*Median weekly earnings among the full-time self-employed have decreased by 10 percent in real terms between 2000 and 2011, meaning they are now around 20 percent worse off than their employed counterparts.*²³

RSA

²¹ Hansard (2014), *Parliamentary debates: written answers* (question from Julie Elliott MP) (188556). Available at:

<http://www.publications.parliament.uk/pa/cm201314/cmhansrd/chan130.pdf>

²² Joseph Rowntree Foundation (1994), *Self-employed and the income distribution*. Available at: (<http://www.jrf.org.uk/publications/self-employment-and-distribution-income>)

²³ RSA (2014), *Salvation in a start-up? The origins and nature of the self-employment boom*. Available at: http://www.thersa.org/_data/assets/pdf_file/0004/1543855/RSA_Salvation-in-a-start-up-2014.pdf

Also using data from the FRS, Resolution Foundation found that:

In 2011-12, the earnings of the median self-employed worker were 20 per cent lower than in 2006-07. Over the same period, employee earnings fell by 6 per cent. ... As a result of these trends, the typical self-employed person earned 40 per cent less than the typical employed person in 2011-12; in 2006-07, the gap was 28 per cent.²⁴

Resolution Foundation

As well as receiving higher median earnings, employees may also benefit from pension contributions from their employer, which the self-employed would not benefit from. Indeed such contributions are set to become the default once Automatic enrolment is fully introduced.

A report from the Department for Work and Pensions (DWP) looked at movements into and out-of low income,²⁵ using data from eighteen waves of the British Household Panel Survey, covering the period 1991 to 2008.²⁶ The report found that:

- Self-employed households had a 10 per cent chance of entering low income in a given year. This was significantly higher than the corresponding figure where all adults were in employment (3 per cent). It was also higher than for couples with one employed, one workless (6 per cent) and pensioners (8 per cent). However the chance of entering low income was lower than the 17 per cent for workless households.
- Self-employed households had the greatest chance of exiting low income in a given year (46 per cent), followed by households with all adults in employment (40 per cent), couples with one employed, one workless (39 per cent), workless (28 per cent) and pensioner (22 per cent).

In summary, the report found that the self-employed have a relatively high chance of both entering low income (the highest of any working group) and of exiting low income (the highest of any group). This may be because the self-employed experience greater income-volatility than other groups, or because different sub-groups of the self-employed are responsible for entering and for leaving low income.

²⁴ Resolution Foundation (2014), *Just the job – or a working compromise?* Available at: http://www.resolutionfoundation.org/media/media/downloads/Just_the_job_-_or_a_working_compromise_1.pdf.

²⁵ The definition of low income used was below 60 per cent of median incomes, before housing costs.

²⁶ DWP (2010), *Low-income dynamics*, table 9. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/200978/low_income_dynamics_1991-2008.pdf

The measure of low income used in the report is income less than 60 per cent of the median, before housing costs. This has hitherto been a widely used measure of poverty, and the report therefore finds that for some people, self-employment represents a significant route out of income poverty.

2.7 Pension saving among the self-employed

The self-employed are less likely than employees to be saving in a private pension scheme. Analysis from DWP found that only 21 per cent of self-employed individuals have saved into a private pension, compared to 50 per cent of all employees.²⁷ Similar results were found by the Resolution Foundation:

Only 31 per cent of self-employed people are contributing to a pension, compared to 52 per cent of employees (either individually or via their employer). This has not changed in recent years (2005-6–2011-12). This is supported by our Ipsos MORI survey, in which just 34 per cent of self-employed respondents said they had any kind of personal pension.²⁸

Resolution Foundation

There are a number of potential explanations for lower pension savings among the self-employed, including:

- with more volatile earnings, the self-employed may look to save into more flexible products (such as an ISA), where their capital can be accessed if required;
- the self-employed have an additional option of investing resources into their businesses, which might offer a greater financial return;
- it is more convenient to save for a pension if employed, with employers typically providing a pension scheme and making additional contributions; and
- with lower average incomes, the self-employed may not be able to afford to save for retirement.

2.8 Summary

In summary, we find that self-employment has increased since the early 2000s, both in absolute terms and as a proportion of all employment. The most recent ONS statistics show self-employment as representing 15 per cent of all employment, compared to 12 per cent at the start of the century. This growth in

²⁷ DWP, *The single-tier pension and people who have spent time in self-employment*. Data taken from the *Family Resources Survey 2010/11*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/181234/single-tier-self-employment.pdf.

²⁸ Resolution Foundation (2014), *Just the job – or a working compromise?* Available at: http://www.resolutionfoundation.org/media/media/downloads/Just_the_job_-_or_a_working_compromise_1.pdf.

self-employment is a common trend experienced across Europe. Its cause is not clear; however plausible explanations include a lack of alternative employee jobs, a reflection of greater entrepreneurial spirit, or the result of structural changes in technology and in the economic shift away from manufacturing and towards services.

Looking at sub-groups of the self-employed, the trend of increasing self-employment was found to be particularly evident within older age groups, and amongst women.

Average incomes of self-employed people were found to be highest in London and its surrounding regions and higher for men than for women. Average income was also found to be decreasing among the self-employed; however this in-part reflects the changing composition of the self-employed workforce.

Whilst the self-employed were found to have a greater chance of entering income poverty than other working groups, they were also found to be the group most likely to exit poverty. Nevertheless, the lower average incomes of the self-employed, along with a lower propensity to save for retirement, suggest this group to be in particular need of support to avoid poverty – either now or in the future.

3. Social security coverage for the self-employed

This chapter sets out the historical context for the current range of contributory benefit entitlements made available to the self-employed. It then looks at the rates of National Insurance contributions paid by the self-employed (alongside the rates paid by employees and employers), and the entitlements they can receive in return.

The chapter then summarises the means-tested support the self-employed may be entitled to, before providing a comparative overview of the support available for the self-employed across Europe.

3.1 The historical context for social security coverage for the self-employed

The self-employed have never been at the centre of any UK National Insurance scheme for people of working age. When the then Chancellor of the Exchequer, David Lloyd-George, introduced a Bill for establishing a system of National Insurance in 1911, no provision was made for the self-employed.

In 1942, the Beveridge Report recognised the need to support those in self-employment, stating that ‘many persons working on their own account are poorer and more in need of state insurance than employees’.²⁹ The report was also clear that such support should not be means-tested. This was, in general, because the proposed scheme was ‘first and foremost, a plan of insurance – of giving, in return for contributions, benefits up to subsistence level, as a right and without means test, so that individuals may build freely upon it’.³⁰ But in the specific case of the self-employed the report further recognised the administrative problems which might arise in ascertaining the extent to which the claimant was working / earning.³¹ The result was a social security system which did not extend coverage to the self-employed in the event of unemployment or short-term illness, but did provide cover for Retirement Pension. In return for a lower level of cover, the self-employed made a lower contribution (of Class 2 National Insurance contributions, rather than Class 1), which were paid at a fixed weekly rate.

These provisions were legislated for, and were not substantially altered until 1961, when contributions (other than for self-employed) became earnings-related – making them closer in nature to an income tax. These were altered again in 1973 when the Secretary of State for Health and Social Services, Sir Keith Joseph, introduced a requirement for self-employed people with earnings above a prescribed limit to pay an additional National Insurance contribution. These earnings-related contributions were designated “Class 4 contributions”. They conferred no additional entitlement to contributory benefits, but were designed to make contributions into the National Insurance Fund more equitable overall. The requirement upon most self-employed earners to pay Class 4 contributions has continued ever since.

²⁹ William Beveridge (1942), *Social insurance and allied services*. Paragraph 4.

³⁰ *Ibid.* Paragraph 10.

³¹ *Ibid.* Paragraphs 119 and 122.

In a report commissioned by HM Treasury in 1998 it was concluded that the self-employed gain substantially more from the National Insurance Fund than they contribute.³² However, Class 4 contribution rates have subsequently significantly increased and the value of contributory benefits have lessened, so it is not clear on a 'value for money' basis where the self-employed stand at the present time.

The current situation has been summarised by the House of Commons Library as follows:

It is an important feature of the National Insurance system that the self-employed contribute less than employees, even given their lower entitlement to benefits – though the relative benefit they enjoy, as a group, was reduced significantly as a package of reforms to the structure of NI in 1999-2001. At present this benefit is put at around £2.85 billion a year – though, as noted in previous written answers on this issue, these estimates are “particularly uncertain due to their complex nature” ... Moreover, this is a figure for the self-employed as a whole; it is possible that the situation may vary across the income spectrum.³³

House of Commons Library

3.2 National Insurance contributions required from the self-employed

The self-employed pay Class 2 National Insurance contributions currently set at £2.75 a week. Exemptions exist for those aged under 16 years, over state pension age, married women who have opted to pay reduced rate contributions and those with very low taxable profit from self-employment (less than £5,885 a year).

The self-employed are also required to pay Class 4 National Insurance contributions, currently: 9 per cent of annual taxable profit between £7,956 and £41,865 and 2 per cent on any earnings above £41,865.

Table 3 shows the rates of National Insurance contributions paid by the self-employed, employed and employers (for the 2014/15 tax year). This is a simplified overview which does not, for example, include the married women's reduced rate, or the contracted-out rebates, which may apply in particular circumstances. It should also be noted that contributions from the self-employed are based upon their taxable profit for the whole year, whereas the employed are assessed upon individual pay periods. This can make comparisons difficult, especially where individuals have two or more earnings streams.

³² Taylor, Martin (1998), The modernisation of Britain's tax and benefit system – work incentives (report number 2).

³³ House of Commons Library (2014), *Self-employed people and contribution-based Jobseeker's Allowance*. Available at: <http://www.parliament.uk/briefing-papers/SN00547/selfemployed-people-and-contributionbased-jobseekers-allowance>

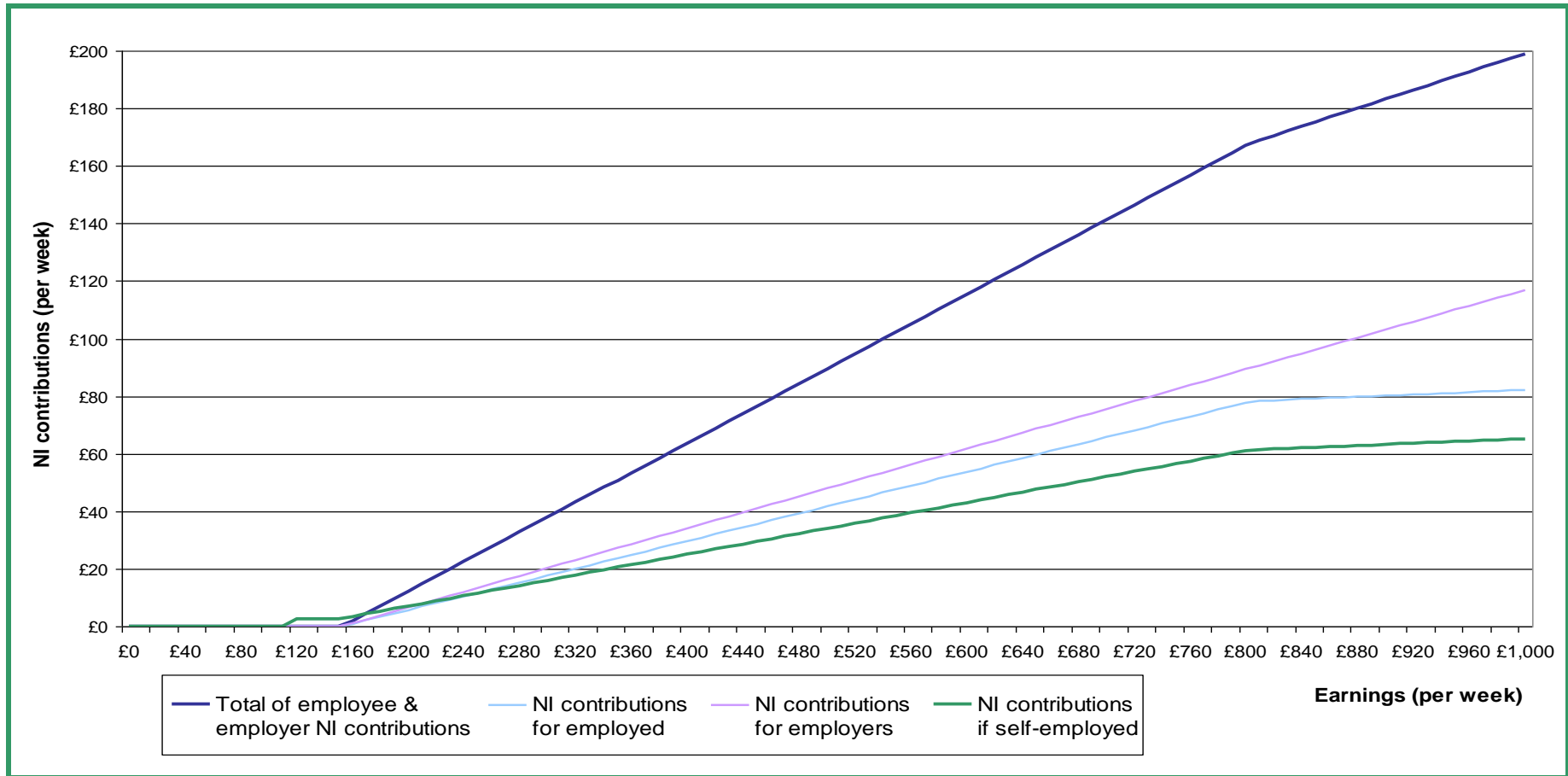
Table 3: National Insurance contribution rates

National Insurance contribution class	Self-employed	Employed	Employer
Class 2	Paid at a flat rate of £2.75 per week where earnings exceed £5,885 per year (£113 per week). ³⁴		
Class 4	Paid at a rate of 9 per cent of annual earnings between £7,956 and £41,865 (equivalent to around £153 to £803 per week) and 2 per cent on earnings above £41,865 per year.		
Primary Class 1		Paid at a rate of 12 per cent on earnings between £153 and £805 per week (£7,978 and £41,975 per year) and 2 per cent on earnings above £805 per week.	
Secondary Class 1			Paid at a rate of 13.8 per cent on earnings above £153 per week (£7,978 per year).

This data is also represented in Chart 4, which shows the National Insurance contributions paid by the self-employed, employed, and employers as weekly earnings rise.

³⁴ Except for 'share-fishermen', who pay the higher rate of £3.40 per week but who then build entitlement to contributory Jobseeker's Allowance.

Chart 4: National Insurance contributions as earnings increase – comparison between the self-employed and employed



It can be seen from Chart 4 that:

- the self employed (in green) pay a lower level of National Insurance than the employed (in light blue) once earnings exceed £246 per week; and
- between weekly earnings of £153 and £803 the self-employed make a contribution of 9 pence per pound earned, in comparison to 12 pence for the employed.

Chart 4 also shows secondary Class 1 contributions (paid by employers) set at a rate of 13.8 pence per pound – a higher rate than is paid by employees or the self-employed, and with no ceiling after which the rate is lowered. Employers might therefore prefer (on purely cost grounds) to engage a self-employed person to carry out business activity for them, rather than hiring an employee. Employment rights such as the National Minimum Wage may provide a further incentive to act in this manner, as they apply only to employees and not the self-employed.

This is not the full story for the contributions made to the exchequer as a result of employment. Those undertaking business activities have a choice:

1. they can remain ‘unincorporated’ as a self-employed individual and pay Class 2 & 4 National Insurance and income tax; or
2. alternatively they can ‘incorporate’ and, as a director / employee, pay Class 1 contributions and income tax. The company would additionally be liable to pay corporation tax and employer’s National Insurance. ‘Incorporation’ would open up the possibility of the ‘owners’ withdrawing funds from the company by way of dividends which are not subject to social security contributions.

3.3 Entitlement to contributory benefits for the self-employed

Self-employed earners who pay Class 2 National Insurance contributions (at the flat rate of £2.75 per week) will gain entitlement to the majority of contribution-based benefits, including State Pension, Maternity Allowance, Bereavement Benefits for a surviving spouse or civil partner, and contributory Employment and Support Allowance. However, they will not gain entitlement to Contributory Jobseeker’s Allowance.^{35 36}

Because the self-employed do not have an employer, they cannot normally lodge a successful claim for Industrial Injuries Disablement Benefit.³⁷ There is also no access to Statutory Maternity Pay (SMP), Statutory Paternity Pay or

³⁵ Unless they are a “share fishermen”, who pay Class 2 contributions at the higher rate of £3.40 per week.

³⁶ A person who has moved from employed earner’s employment to self-employment within the past two years may still be able to qualify for contributory Jobseeker’s Allowance on the basis of their previous contribution record.

³⁷ This barrier is lifted if the injury or disablement occurred whilst the person was on a Government approved training course.

Statutory Adoption Pay. These benefits are administered by employers, with the amount paid being related to the employee's average weekly earnings. In general the rate paid is the lesser of either £138.18 per week, or 90 per cent of average weekly earnings. However for the first six weeks of SMP the rate paid is 90 per cent of average weekly earnings (i.e. the £138.18 becomes irrelevant). These payments are largely reimbursed by the social security system through compensating reductions in employers' National Insurance contributions.³⁸

Self-employed mothers (or mothers-to-be) would be entitled to Maternity Allowance in place of SMP. This would be paid at the flat-rate of £138.18. It could therefore be either more or less than SMP during the first 6 weeks, but could not be less than SMP thereafter.

Statutory Sickness Pay is also administered by employers, though from 5th April 2014 it is no-longer reimbursed by the government.

Neither Class 2 nor Class 4 contributions have historically conferred entitlement to Additional State Pension (including State Second Pension, State Earnings-Related Pension, and State Graduated Pension). However the self-employed will build entitlement for the new 'Single Tier Pension' when it is introduced for those reaching State Pension Age from April 2016.

In summary, entitlement to contributory benefits for the self-employed diverges from that of the employed in two areas: statutory pay and Additional Pension. In both cases the self-employed receive less than their employed counterparts. However the self-employed are eligible for Maternity Allowance, and the disparity in state pension provision entitlement will disappear following the introduction of the Single Tier Pension.

3.4 Entitlement to means-tested benefits and tax credits

As well as contributory benefits, the self-employed may be entitled to means-tested support, if they have a low income. This is currently provided through a range of benefits including: Working Tax Credit, Child Tax Credit, and Housing Benefit. If they lose their (self-) employment they may become eligible for Income Support or income-related Employment and Support Allowance.

Table 4 shows that in the year 2012-13, around 800,000 families which included a self-employed member received tax credits.

³⁸ For further information see <https://www.gov.uk/recover-statutory-payments/reclaiming>.

Table 4: Families in receipt of tax credits with at least one member identified as self-employed (thousands)

<i>Tax year</i>	<i>Families benefiting from both WTC and CTC</i>	<i>Families benefiting from WTC only</i>	Total
2007-08	740	80	820
2008-09	760	100	860
2009-10	780	130	910
2010-11	800	150	950
2011-12	750	160	910
2012-13	600	170	770

Source: finalised tax credits administrative data.³⁹

These benefits are currently being replaced by Universal Credit (UC) which, once fully implemented, is expected to be received by around 700,000 self-employed families (where self-employment is the main employment for at least one family member).⁴⁰ This definition of self-employed families is tighter than that used in Table 4, meaning the figures cannot be directly compared.

The changes required in moving from the current system of benefits and tax credits to Universal Credit will have a particularly significant impact on the self-employed. One example of this is the 'Minimum Income Floor' which will be introduced as part of UC. This will effectively limit the amount of means-tested support which a self-employed claimant can receive, by assuming a level of income equivalent to working at the National Minimum Wage, for the number of hours which would be expected of an employed claimant in otherwise similar circumstances. There are also major changes for the reporting of income. SSAC has previously reported on the impact of Universal Credit on the self-employed, including these aspects of the policy.⁴¹ We share further concerns in the following chapter.

³⁹ Hansard (2014), *Parliamentary debates: written answers* (question from Guto Bebb MP) (202509). Includes. The decrease in the number of self-employed households in 2012-13 can largely be explained by the removal of the "second income threshold" of tax credits in April 2012. This policy change removed a large number of higher income households from the whole tax credits population. Available at: http://www.publications.parliament.uk/pa/cm201415/cmhansrd/cm140703/text/140703w0001.htm#140703w0001.htm_wqn21

⁴⁰ Hansard (2014), *Parliamentary debates: written answers* (question from Stephen Timms MP) (129071). Available at: http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm121126/text/121126w0006.htm#121126w0006.htm_wqn45

⁴¹ DWP (2012), *Universal Credit and related regulations report and government response*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/325291/ssac-universal-credit-report.pdf

3.5 The support available to the self-employment across Europe

The following section provides additional context for the social security coverage provided to the self-employed in the UK.

Overall, arrangements for meeting the social security needs of self-employed workers in Europe are extremely complicated. There is reasonably extensive coverage against the risks and contingencies faced. However, eligibility, qualifying criteria, contribution rates and payment conditions are varied. Almost all member states (25 out of 27) provide cover for illness or disability, two-thirds (18) make some efforts to mitigate occupational injury or disease and 12 arrange cover in the event of unemployment. However, only three member states (Hungary, Luxembourg and Slovenia) provide cover for all these contingencies on a compulsory basis.

There are three broad approaches to providing support for working-age self-employed claimants:

- First, there are sectoral and occupational schemes. In Germany, as in Austria, Luxembourg, France, Italy, Greece and Spain, social security for the self-employed is structured around a series of professional schemes. According to the MISSOC returns, there is a complicated range of provision for self employed craftsmen and retailers within the framework of the general system of social security, with independent systems for farmers, artists and for members of other professions.⁴²
- Second, there is the example of a separate and dedicated social insurance scheme for the self-employed used in Belgium. This does not provide coverage for occupational injury.
- Third are those countries, (including the UK) who protect the self-employed through general social security arrangements.

In providing pensions to the self-employed, Schoukens finds that there are basically two types of system used across Europe: on the one hand, those basic allowances (that can be supplemented through voluntary contribution); and on the other, those which are income-related. In both cases residence and contribution history are required. In the first group are: Denmark, Sweden, Finland, the Netherlands, UK, Ireland, Germany (for farmers) and France (for the liberal professions such as law, medicine or engineering). In the second group are: Germany (excepting farmers), France (excepting liberal professions), Italy, Luxembourg, Spain, Portugal, Austria and Greece. Denmark stands out as the country where self-employed workers have the same social security entitlements as employees.⁴³

⁴² Mutual Information System on Social Protection (MISSOC) (2013), *Social protection of the self-employed*, Accessed on 1 July 2013, Available at:

<http://www.missoc.org/MISSOC/INFORMATIONBASE/COUNTRYSPECIFICDESCS/SELFEMPLOYED/socialProtectionSelfEmployed2012.jsp>

⁴³ Ibid.

European law

The definition of being a self-employed person is a national rather than a European construct. The complexity/ambiguity of the status of being self-employed is significant because in some contexts, as they relate to EU law, the self-employed may be regarded as 'citizens' and sometimes as 'workers'. Each designation brings with it different rights and obligations. For example, Jorens and Lhernould state that 'Article 7[2] of EU Regulation 1612/68 which provides that social and fiscal advantages should be provided without discrimination on the grounds of nationality, may not (be) applicable to self-employed people'. However, as citizens, the self-employed have the right to move freely within the boundaries of the EU and as such acquire rights and entitlements.⁴⁴

Compared to employees there is little European law that directly impacts on the self-employed and their entitlement to social security. However, in June 2010 an EU Directive on self-employed workers and their spouses was adopted and this provided for improved social protection for the self-employed, including the right to maternity leave for the first time. The Directive granted women who were self-employed, or who assisted a self-employed spouse or partner, a (voluntary) maternity allowance and a leave period of at least 14 weeks. The Directive has been implemented in both Great Britain and Northern Ireland.

3.6 Summary

In common with most other European countries, the UK treats the self-employed differently to employees both in terms of contributions and entitlements. In particular, the self-employed may, depending on circumstances, make National Insurance contributions at a significantly lower rate than those made by the employed (especially when taking into account the secondary Class 1 contributions also paid by employers). This disparity, to a certain extent, reflects a lower entitlement to contributory benefits for the self-employed, and this is particularly true in the domain of pensions (prior to the introduction of the Single Tier Pension). However, the disparity in contribution levels between the two groups seems large in relation to the difference in benefit entitlement. It might be considered that such a disparity would have been unlikely, had the self-employed been held in sharp focus in the design and evolution of the social security system. This imbalance of contributions paid by the self-employed as compared to the combined liabilities of employees and their employer has is considered to be a significant contributory factor in the growth of so-called 'false self-employment' as we shall consider in the next chapter.

⁴⁴ Y Jorens and J-P Lhernould (2010), *Europe of the self-employed: Self-employed between economic freedom and social constraints*.

4. Issues that need to be addressed

The following chapter raises some of the particular concerns of the Committee about the support available to the self-employed; on the boundary between employment and self-employment, and on the approach taken to this group under Universal Credit. In both cases further study would seem warranted in order to ensure the social security system is able to respond to the changing structure of the labour market and the particular needs of the self-employed population.

4.1 The boundary between employment and self-employment

Social security legislation defines self-employment negatively. An “employed earner” is a person who is gainfully employed, either under a contract of service or in an office.⁴⁵ Those gainfully employed but not falling into the category of “employed earner” are considered to be “self-employed earners”.⁴⁶

It may in some instances be unclear whether a person is employed under a contract of service (making them an employed earner) or a contract for services (making them a self-employed earner). In such instances, case-law can point to factors which might distinguish between the two categories.⁴⁷ However, uncertainty can remain, as highlighted by the Fair Work Coalition:

*Decisions on employment status are taken by the courts and tribunals on a case by case basis, depending on the facts, the terms contained in an individual’s contract and the day to day reality of the individual’s employment relationship. As a result, the only way to determine for sure whether an individual is a ‘worker’, an ‘employee’ or ‘self-employed’ is to take a claim to an employment tribunal. This is costly and time-consuming for all parties involved and extremely daunting for vulnerable workers who may fear victimisation or dismissal for asking for trying to enforce their rights.*⁴⁸

Fair Work Coalition

⁴⁵ The term ‘office’ is not defined in the legislation itself, but is interpreted within tax case law as “a permanent, substantive position which has its existence independent of the person who fills it, and which went on and was filled by successive holders.” 19 November 2010. Belgian-EU conference, Brussels. *Europe for self-employed persons*

⁴⁶ Social Security Contributions and Benefits Act 1992, Section 2(1), c.4. Available at: <http://www.legislation.gov.uk/ukpga/1992/4/contents/enacted>

⁴⁷ Guidance from HMRC is available to help determine employment status, at: <http://www.hmrc.gov.uk/working/intro/empstatus.htm>

⁴⁸ Fair Work Coalition (2010), *Fair work: fighting poverty through decent jobs*. Available at: <http://www.tuc.org.uk/sites/default/files/documents/fairworkreport.pdf>

The uncertainty as to status not only applies in relation to employment law, but also in interpreting social security law, tax law and the National Minimum Wage legislation. Unfortunately, all these branches of law make their own subtle distinctions, either in Statute or through the interpretation of the Courts. This uncertainty has created an opportunity for 'false self-employment'. This occurs where employers (re)define their employees as being self-employed, which would not be appropriate if they effectively work for the 'employer'. This 'false self-employment' is generally bad for low-paid workers who may be exploited by 'employers' wishing to avoid employers' contributions as well as the employment law rights of 'employees'.

The financial incentives to undertake 'false self-employment', which stem from the difference in the rate of National Insurance contributions between the self-employed and employed, are likely to be strengthened further following the introduction of automatic enrolment. This will require employers to make contributions to their employees' pensions (so long as the employee does not opt out of their pension scheme).⁴⁹ Automatic Enrolment will not apply to the self-employed.

From the employee's point of view, moving from employment to self-employment may lower their own NI contributions. However they would then lose entitlement to Contributory Jobseeker's Allowance, Statutory Maternity / Paternity / Adoption / Sick Pay, as well as rights under employment law.

As 'false self-employment' can be undertaken as a means to circumvent employment rights, including the UK's National Minimum Wage, it is especially relevant to industries typically paying lower wages, including construction, agriculture, hotels and social care. In this context, Jorens finds that:⁵⁰

*Traditionally, employed persons enjoy more rights than the self-employed. The labour rights concern rules regarding wage and salary protection (working time, minimum remuneration, manner and place of payment), terms and conditions of employment, the working schedule (limits on working hours, rest periods, Sunday rest, breaks), rules on social records, supplementary pensions, interim work, additional social advantages, the continuation of payment of remuneration by the employer during sick leave, the protection against dismissal, annual and special leave.*⁵¹

Professor Yves Jorens

⁴⁹ Employers will initially make minimum payments of 1% of 'qualifying earnings', rising to 3% by 2018 (when the introduction of Automatic Enrolment is intended to be complete). More information is available at: <https://www.gov.uk/workplace-pensions/what-you-your-employer-and-the-government-pay>.

⁵⁰ This issue was highlighted by Unite in its submission to the Low Pay Commission's *National Minimum Wage* report (2013). Unite was concerned about the loss of employment, rights including entitlement to the National Minimum Wage, which was of particular concern amongst migrant workers in London's hotel sector.

⁵¹ Jorens, Y (2010) *Self-employment and bogus self-employment in the European construction industry: a comparative study of 11 Member States*. Available at: <http://www.efbww.org/pdfs/annex%208%20-%20Brochure%20part%201%20%5BEN%5D.pdf>

There is growing awareness of the problem of 'false' or 'forced' self-employment across Europe and several countries have introduced measures to counteract the trend, including tighter definitions of employment status, and adjustments to tax rules that have the effect of increasing the self-employed person's tax and insurance contributions up to the minimum contributions of other employees. A key factor in the UK is the nature of the employer's contribution and whether that needs to be viewed as part of the overall tax system, not just the National Insurance system. There has been considerable debate⁵² over the last few years as to whether the income tax and national insurance contribution systems should be merged. Indeed in his Budget statement in 2011, following that debate, the Chancellor of the Exchequer stated that '*it is time that we take this historic step to simplify our tax system and make it fit for the modern age*'. If the Government were to take such a step it could go some way to providing a solution.

In the meantime, the Government is aware of, and has been looking at options for addressing, 'false self-employment'. It has taken steps in the Finance Act 2014 to address the issue of 'false self-employment' through the use of an 'employment intermediary'.⁵³ The Government explained the issue of false self-employment in the foreword to its prior consultation, published in December 2013:

This Government strongly supports enterprise and those who choose to work for themselves. We believe that the tax system should continue to recognise the additional risk someone who is self-employed takes on. However, there is increasing evidence that some companies and Employment Businesses are using employment intermediaries to disguise the employment of their workers as self-employment primarily to avoid employer National Insurance and reduce the costs associated with workers employment rights.

These practices are not right and by engaging in them some businesses are gaining an unfair advantage over competitors. Often workers are unaware that they are self-employed and losing out on employment rights such as the National Minimum Wage and access to Statutory Payments like sick pay. Equally, there are cases where workers are aware of these arrangements, but have little choice but to accept them or lose the job. Workers are often obliged to pay a fee to the employment intermediary which can be as much as £25 per week.⁵⁴

Exchequer Secretary to the Treasury, HM Revenue & Customs

⁵² Institute for Fiscal Studies (2011) *Reforming the Tax System for the 21st Century: The Mirrlees Review*. <http://www.ifs.org.uk/publications/mirrleesreview/> and The Office of Tax Simplification (2014) Review of employee benefits and expenses: final report: <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-final-report>

⁵³ HM Revenue & Customs (2013), *Onshore employment intermediaries: false self employment*. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264649/Onshore_employment_intermediaries_-_false_self_employment.pdf

⁵⁴ HM Revenue & Customs (2013), *Onshore employment intermediaries: false self employment*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264649/Onshore_employment_intermediaries_-_false_self_employment.pdf

Alternative approaches have also been proposed. For example, Centre Forum suggests a move towards more equal rates of contribution between employment and self-employment. They argue that this would weaken the incentive for employers to engage in 'false self-employment' in order to avoid National Insurance contributions.

*Aside from a small disparity in Jobseeker's Allowance, there is no compelling reason for the self-employed to pay any less into the system. The large tax differential leaves the door open to tax avoidance and benefits the richest most.*⁵⁵

Centre Forum

The report from Centre Forum also suggests that by increasing the National Insurance (Class 4) rate paid by the self-employed, scrapping Class 2 contributions (to avoid unnecessary complexity), and raising the threshold above which National Insurance contributions are paid, 'the poorer 50% of self-employed workers would also be winners or unaffected, despite the increase in rates'.⁵⁶

Any restructuring of the social security system would need to consider the option open to entrepreneurs to 'incorporate' their business activities.

4.2 Issues arising from our previous work on Universal Credit and the self-employed

The Social Security Advisory Committee has previously reported on the impact of Universal Credit on the self-employed. In 2012 SSAC identified a number of challenging issues for both DWP and the self-employed when it came to the practical operation of the UC regulations. On 23rd August 2012, SSAC delivered its report on UC and related regulations to the Secretary of State for Work and Pensions which included a number of observations and recommendations on these issues.

The Government formally responded in December 2012 announcing some proposed changes, but not adopting all of SSAC's recommendations.⁵⁷

It has been almost two years since SSAC looked in detail at those regulations and UC is now live in parts of the UK, albeit with, as yet, small numbers (and it would appear only a handful of self-employed claimants). However we here re-visit our original recommendations and review other developments over the past two years, to see if additional recommendations are now appropriate.

⁵⁵ Centre Forum (2013), *Ending the self-employment tax break*. Available at: <http://www.centreforum.org/assets/pubs/self-employment.pdf>

⁵⁶ Ibid.

⁵⁷ DWP (2012), *Universal Credit and related regulations report and government response*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/325291/ssac-universal-credit-report.pdf

Against this background, SSAC took the following actions in 2014:

- spoke to a number of stakeholders with an interest in the self-employed;
- reviewed again the UC regulations that apply to the self-employed;
- reviewed the internal guidance supplied to Departmental decision-makers on self-employed matters; and
- reviewed the external guidance provided on the internet to the self-employed currently receiving UC.

SSAC's original recommendations and the Government response

Back in August 2012 we recommended (in summary):

- a continuing engagement with industry groups in order to understand and minimise any negative impacts on business;
- that the Government give clear guidance on the status, in terms of conditionality and more generally, of quasi-self employed claimants. Quasi self-employment occurs where employers or employment intermediaries engage people on the basis that they will be regarded as self-employed, without making this sufficiently clear to the individual. The Committee were concerned that the Minimum Income Floor might be applied in such cases, were the claimant was in fact seeking work rather than developing a business; and
- that the Government give further consideration to its policies on monthly reporting of earnings and alignment with wider government self employment rules, permitted expenses and rolling forward losses, and for allowing more than one start up period in a lifetime. We also recommended that the Government consider a full reconciliation of self-employed business gains and losses balanced with Self Assessment returns and, together with HM Revenue and Customs, move towards a unified reporting regime.

The Government responded in December 2012 as follows (in summary):

- whilst recognising that self-employment provides a vital contribution to the economy and that the Government was keen to help self employed people to achieve their potential and to progress in work, there was a balance to be achieved. UC should support people to be self employed, but only insofar as self-employment is the best route for them to become financially self sufficient;
- agreeing that active consultation with representative stakeholder groups was vital and that they had set up mechanisms to achieve that end. In addition, the Government sought to distinguish between those who were

genuinely self-employed and developing their businesses rather than those who might be regarded as self-employed through a technicality;

- recognising the need for claimants who are setting up a business to be given time to establish themselves, such claimants, who had been self-employed for less than 12 months, would be granted a start-up period. This meant that claimants would not be required to satisfy work-search or availability requirements, and the Minimum Income Floor would not be applied. The Government agreed to allow further start up periods for self-employed claimants; one new start-up period every five years;
- emphasising that, where possible, income reporting for self-employed claimants would be aligned with the new cash income reporting system that HMRC would develop to simplify tax. DWP would be working closely with HMRC on the two systems to make them as simple as possible. The Government stated its ambition that the information collected for the monthly submissions required for UC could be used for tax purposes at the end of the year. Also the Government recognised the concerns on the current inability to carry forward losses from previous assessment periods under UC and agreed to revisit this issue; and
- agreeing that monitoring of the self-employed under UC was essential and diverse methods would be employed.

4.3 Further considerations on UC and the self-employed

In light of our ongoing work on the impact of UC upon the self-employed, we have the following concerns, additional to those raised in our original report:

4.3.1 Fluctuating incomes and expenses

The diversity of the self-employed and the patterns of their profits (or otherwise) is extremely varied. This was acknowledged by the Government in agreeing to consider some form of loss carry-forward from month to month. We have yet to see any workable proposals coming forward from DWP.

But the issue is wider than this. In principle, we believe that over an annual business cycle the amount received in UC support by individuals with similar profits and the same personal circumstances *should* be roughly the same. This does not necessarily seem to be the case with the current structuring of UC, the impact of the Minimum Income Floor and the differences in expenses rules between the tax and UC systems.

Some types of seasonal work are particularly worthy of more study. As a Research paper published in 2013 identified:

*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.*⁵⁸

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4.3.2 Distortion of business decisions

The tax system has been honed over many decades to allow businesses to make common commercial decisions without worrying about the resulting tax consequences. We fear that this is not the situation with UC. For example:

- UC has placed a monthly cap upon the amount of business interest that may be taken into account in arriving at profits for UC purposes. This may lead to the forced artificial “planning” of interest payments so as to ensure the maximum award of UC;
- the purchase, lease or acquisition of a car cannot be taken into account in the calculation of profits for UC purposes. Some businesses are based on car ownership, for example mobile care workers, taxi-drivers etc. Such businesses would be forced to rent a car (likely to be more expensive) in order to be able to deduct a legitimate business expense under UC;
- pre-trading expenses, which are a legitimate business expense in a business start-up situation are apparently ignored under the UC rules;
- taxation and National Insurance contributions are regarded as deductions from income for the calculation of UC. However, there is little recognition in the UC regulations of the different methods of collection that apply under the tax system (payments on account, withholding at source, the Construction Industry Scheme, etc.) and the ability of the PAYE system to report a sum collected as tax when it is, in reality, something completely different (for example, a debt). Without appropriate recognition of these issues “planning” will take place to make such payments fit the UC rules.

4.3.3 Monthly accounting and multiple rules

For many small businesses accounting for their business transactions is one of the more difficult and onerous responsibilities, leading many to hire an accountant. However, hiring an accountant to help with monthly UC calculations is likely to be too expensive to consider.

It is not only the frequency of calculation that is the problem. UC assessment periods can run to any day of the month, depending on the date the claim was made. This will make it difficult for claimants to make up their records to fit

⁵⁸ Roy Sainsbury and Anne Corden (2013). *Self-employment, tax credits and the move to Universal Credit* (research commissioned by DWP). Available at: <http://www.york.ac.uk/inst/spru/pubs/pdf/rrep829summ.pdf>

both UC and tax reporting requirements. Furthermore, despite the Government's best intentions of aligning the UC rules with the optional cash basis under HMRC's Self-Assessment regime, there remain significant differences. It will be necessary, if frequent mistakes are to be avoided, for the self-employed to understand these disparities.

GOV.UK suggests that if you need help to understand the cash basis that you should 'talk to a chartered tax adviser, accountant or legal adviser'.⁵⁹ When this complexity is added to quarterly accounting for VAT (and varied VAT regimes); procedures for claiming exemption from Class 2 National Insurance on the basis of small self-employed earnings; and the different requirements of local councils for council tax support claims, it can be seen that this aspect of UC may make the self-employed consider whether the administrative burdens are beyond their capabilities.

4.3.4 Information and guidance

There is very little information or official guidance on how UC will affect the self-employed. We would have expected that with UC now being in payment, further guidance would have been provided. GOV.UK provides basic information such as in the summary document *Universal credit and self-employment*.⁶⁰ But this does not prepare an individual to understand the basic rules, the choices open to them and what is required to comply with UC regulations.

DWP has been actively encouraging those on benefits to take up the New Enterprise Allowance, which is a gateway to self-employment. Between April 2011 and April 2014, 46,000 people started receiving the Allowance and they would be, we suggest, an ideal group to work with to identify their UC information and guidance needs.⁶¹

The Department does have its own internal guidance drafted for the use by decision-makers.⁶² However, from our examination of the detailed advice given it is far from clear as to whether much of it will be understandable to those who have not been trained in accounting issues. It is also not clear how much co-operation has taken place across government departments in order to codify terminology which is of relevance to the self-employed, for example the tests for establishing who is self-employed.

⁵⁹ GOV.UK (2014), *Simpler income tax: cash basis*. Available at: <https://www.gov.uk/simpler-income-tax-cash-basis/how-cash-basis-works>

⁶⁰ DWP (2014), *Universal Credit and self-employment*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/322280/uc-and-self-employment-quick-guide.pdf

⁶¹ Figure taken from DWP (2014), *Great Britain New Enterprise Allowance quarterly official statistics*. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/320565/new-enterprise-allowance-official-statistics-june-2014.pdf

⁶² Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/260385/admh4.pdf

5. Recommendations

This report found self-employment to have increased since the early 2000s, both in absolute terms and as a proportion of all employment. The most recent ONS statistics show self-employment as representing 15 per cent of all employment, compared to 12 per cent at the start of the century. In addition, average incomes among the self-employed were found to be lower than among the employed, as was their propensity to save for retirement. Whilst we also found that self-employment can be a significant route out of poverty for some, these trends suggest a rising level of support will need to be directed towards the self-employed in future.

Against this background we found that the different approaches taken towards the National Insurance contributions regime for the self-employed, as compared with the employed, has led to distortions in behaviour for both the self-employed and for employers who want to 'employ' workers at the lowest cost to themselves. The introduction of the 'Single Tier Pension' (which will be available to the self-employed), and automatic enrolment into workplace pensions (which will not apply) may provide further financial incentive for 'false self-employment'.

Recommendation 1:

We recommend that the Government undertake a detailed examination of the comparative levels of social security contributions and entitlement between employees and the self-employed.

This should consider the extent to which:

- **the present system provides an appropriate value for money for both the employed and self-employed deriving from social security contributions;**
- **the current structuring of the social security system provides incentives for 'false self-employment'; and**
- **it is possible to rationalise the definitions of who is (and who is not) self-employed for the purposes of employment, National Minimum Wage, taxation, and social security law.**

By providing a comparable level of cover between the two groups (both in terms of entitlements and contributions) and a greater certainty as to status, the Government can ensure a level playing field in the labour market, and that all workers receive adequate protection from the unforeseen events the social security system is intended to address.

.. ————— ..

The report has also highlighted (in section 4.3) a number of concerns relating to the rules of Universal Credit and their application to the self-employed. These concerns have arisen from the Committee's ongoing work on the impact of UC, and follow our 2012 report on *Universal Credit and related regulations*, which itself makes recommendations on the application of UC to this group.

The additional concerns outlined in this report are on the topics of: fluctuating incomes and expenses, the distortion of business decisions, the requirement of monthly accounting, and the available guidance for claimants. As these are not simple issues we recommend a working group be established to bring together the best evidence and expertise to address these concerns.

Recommendation 2:

We recommend that DWP establish a working group to address a number of concerns on the policy and application of Universal Credit for the self employed. These concerns are on the topics of:

- **Fluctuating incomes and expenses** – modelling capability and voluntary/commercial sector representation should be utilised to better understand the range of impacts possible as a result of fluctuating incomes/expenses or seasonal working, and to consider if changes might be advisable.
- **Distortion of business decisions** – the working group should examine the UC regulations in depth to identify incentives to distort ordinary business behaviour and make recommendations for change.
- **Monthly accounting and multiple rules** – the working group should re-examine the differences between the tax and UC systems and see if further simplification and alignment is possible. If not, DWP must invest in online tools to enable small businesses to make sense of their situation.
- **Information and guidance** – professional tax and accounting bodies should be invited to join the working group to review the guidance provided to decision-makers. If this is, after adjustment, agreed as fit for purpose, it may then form the basis of guidance provided to self-employed claimants via GOV.UK – to clarify the UC rules and help avoid error.

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