



HM Revenue  
& Customs

*Research report*

# Understanding the in-year finalisation process for self-employed tax credit customers

HM Revenue and Customs report 439

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## Understanding the in-year finalisation process for self-employed tax credit customers

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### *About Business Customer and Strategy (BC&S)*

Business Customer and Strategy is part of Business Tax.

The goal of BC&S is to maximise Business Customer compliance for HMRC at best cost for both HMRC and the customer. This is done by developing business tax strategies through customer understanding, working with teams in HMRC and across government departments.

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## Understanding the in-year finalisation process for self-employed tax credit customers

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### *Research requirement (background to the project)*

Universal Credit (UC) will replace several existing benefits, including tax credits. Eventually, the tax credits regime will cease and no new tax credit claims will be accepted. When a customer transitions to UC from tax credits, HMRC will need to finalise their current-year tax credits award through an assessment of the customer's income for the period of time, within the financial year, during which they were in receipt of tax credits. For employees this calculation should, in most cases, be relatively straightforward. For self-employed claimants, however, providing part-year income information may be more complex.

HMRC needed to develop a clear understanding of the issues that self-employed claimants may experience, and the information they require, when ceasing their tax credits award. These insights will be used to inform plans for managing communications with self-employed claimants. As a large proportion of self-employed claimants use an agent to act on their behalf or seek support from Voluntary and Community Sector (VCS) organisations, it is also necessary to engage with the agent community to understand how HMRC might be able to better support them, to support their customers.

Therefore, HMRC commissioned independent research which aimed to:

- Explore the self-employed reaction to, and understanding of, the stopping of tax credits and transition over to Universal Credit, including any difficulties or barriers which they may face and actions they may take.
- Understand the self-employed reaction to the proposed in-year finalisation of tax credits awards based on taxable trading profits and if this solution is manageable.
- Identify where customers are likely to have difficulties in providing this information to inform the support/communications/guidance that may be required.
- Understand what advance information self-employed claimants will require, and when, in order to be adequately prepared for the transition from tax credits to Universal Credit.
- Establish areas of particular challenge, where self-employed claimants may turn to intermediary organisations, or to paid agents, for assistance. This will inform HMRC's approach to supporting customer representative organisations.

### *When the research took place*

Qualitative fieldwork took place between February and April 2014.

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### *Who did the work (research agency)*

The work was carried out by TNS-BMRB, an independent social research agency.

### *Method, Data and Tools used, Sample*

The research was conducted in two phases:

- **Phase 1** focused on exploring the in-year tax credits finalisation requirements, together with agents' views about the stopping of tax credits process and self-employed claimants' likely support needs
- **Phase 2** focused on further understanding self-employed claimants' support and communications needs for the in-year finalisation requirements

#### **Phase 1:**

**21 face-to-face interviews (followed by a further 21 'follow up' telephone interviews) with self-employed customers who claim tax credits** including a mix of: single and multiple income sources; a range of household income (under 10k, 10-20k, 20k+); variable and stable income; inexperienced and experienced with self-assessment; a variety of sectors (consultants, arts / entertainment, producers, services).

All self-employed claimants in this sample were self-represented.

Fieldwork took place in eight locations (Glasgow, Edinburgh, Leeds, Manchester, Liverpool, Cardiff, Bristol and London).

Participants were shown a variety of stimulus materials including mocked-up letters and introductory text about the stopping of tax credits process and its requirements, to assess likely reactions and responses.

**16 telephone depth interviews with agents/ intermediaries** – consisting of a mix of Voluntary and Community Sector (VCS) and paid organisations including those who dealt with tax credits claims on self-employed claimants' behalf as well as those in an advisory or support role.

#### **Phase 2:**

Four focus groups split between London and Leeds with a total of 29 self-employed customers who claim tax credits.

The individual groups included a broad mix of respondents across income level, income type, stability of income, industry sector and experience with self-assessment but were recruited to a specific, single quota as detailed below:

- Group 1 - Complex, multiple income sources (joint claims with 2-3 sources of income)

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- Group 2- Lower income (under 10k)
- Group 3 - Seasonal incomes (can predict 2-3 months of year where income lower)
- Group 4 - Self-employed claimants split equally between 1) those who **use accountants** to undertake their SA return and 2) those who had registered but not yet filed an SA return.

Group participants were also shown a variety of stimulus materials about stopping tax credits and its requirements, to assess likely reactions and responses.

All the recruitment of self-employed claimants and agents / intermediaries was conducted using a mixture of HMRC sample and free-find methods.

### *Main Findings*

#### *Understanding self-employed customers' reactions to the stopping of tax credits*

In this sample, self-employed claimants had generally *heard about* Universal Credit through the media, although their understanding of the likely impact on them was limited and in many cases, self-employed claimants were not aware which of their benefits would be affected. As a result, when asked about the transitioning requirements for closing their tax credits award, self-employed claimants tended to focus on wider questions regarding Universal Credit, for example the impact on the amount of money they received or the regularity of their payments.

These broader uncertainties may have influenced their responses to the transitioning requirements and therefore may need to be addressed in any communications going forward.

#### *Understanding the self-employed reaction to the proposed process for in-year finalisation of tax credits based on taxable trading profits*

#### **Stopping tax credits process: completing a part-year income calculation from the customer perspective**

*During the research, self-employed claimants were asked how they would react to being asked to provide income information for part of the tax year.*

**Overall, self-employed claimants in this sample did not consider providing part year information to be problematic as it was largely seen as being similar to calculating profit details for self-assessment, which most were accustomed to doing.**

However, the potential complexity of the part-year calculation differed according to a number of key factors – income patterns, record-keeping practices, experience of self-assessment and general financial knowledge and confidence.

In this sample, the income patterns for self-employed claimants fell into one of three types:

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### Large number of small cash transactions:

- Included occupations such as taxi drivers or hairdressers
- Record keeping was usually undertaken on a daily or weekly basis
- **Most** were confident they could undertake a part-year calculation
- **Some** said they would find the task more challenging and worried their calculations may be less accurate:
  - **inexperienced** in undertaking self-assessment, **nervous** about undertaking the calculation, likely to experience confusion around terminology and claimed they would contact HMRC for reassurance
  - **less organised** with their record keeping, **confused** about terminology such as income, earnings and profit and more likely to over-estimate their income in order to avoid an over-payment of tax credits
  - **complacent and relaxed** about record keeping, more likely to provide a 'best guess' based on records to hand and more likely to underestimate income if their records were incomplete

### Small number of large transactions:

- Included occupations such as consultants and contractors
- Used bank statements and accounting software to manage their accounts (as they were paid by cheque or *Bankers' Automated Clearing Services* (BACs))
- Had questions about expenses which fall outside of the part-year period and wanted clarification on how these should be dealt with

### Multiple sources of income:

- Record keeping tended to be quite time consuming and was only undertaken when convenient
- Concerned about the time it would take to collate records from different sources, especially if the request fell at a particularly busy time for them

The variability of income was also a key factor.

For the majority who had **very variable** incomes, they said they could not or did not want to provide an estimate and would therefore calculate their actual in year income.

For the minority whose income **varied little**, from year to year, they said they would provide a part-year income based on an estimate of their previous year's accounts as this would be easier and less time consuming.

There were a few points which may prove challenging for self-employed claimants completing a part-year calculation:

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- A general lack of understanding about the definition and therefore meaning of the terms **income, earnings** and **profit**:
  - What 'income' includes e.g. benefits, interests on savings, etc.?
- Habitually used to providing income details for tax credits for **a full year** and often did not notice that the requirement was for **a part-year** income estimate:
  - Many assumed the request was for a full, rather than part-year calculation and failed to notice the part–year date range provided on the stimulus
- Uncertainty about **how** to complete a part-year income calculation

Where self-employed claimants were **represented by an agent**, they expected their accountant to undertake the part-year calculation. The prospect of being charged an extra fee was not an initial consideration, and these customers found it hard to estimate how much extra they would be willing to pay.

**Unrepresented** claimants did not consider they needed support from an accountant, especially in the light of the potential cost (the primary reason most did not use an accountant).

It was tricky for self-employed claimants to predict the best time of the year to provide a part-year calculation but overall, **aligning the requirement with self-assessment end of year reporting was perceived to be sensible as the prepared accounts could be used for both self-assessment and tax credits finalisation.**

However, self-employed claimants expressed a desire for Christmas and other holiday periods to be avoided.

Those with seasonal incomes also wanted **their** busy periods to be avoided, although these periods varied according to the type of business they ran.

**Agents/Intermediaries** unanimously saw December and January as a time to avoid, given that it is a particularly busy time of year for them.

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### **Stopping tax credits process: *reactions to providing an income range from the customer perspective***

*During the research, self-employed claimants were asked to look at an alternative part-year income request. HMRC would provide them with an <sup>1</sup>income range. The customer would be required to notify HMRC only if their income did not fall within the range provided.*

The initial reaction was that this approach was helpful and they felt 'comfortable' with it.

However, after some consideration, participants questioned whether the income range presented was too wide and whether this could lead to over or under-payments.

Consequently, participants assumed that if HMRC provided an income range, **adjustments could be made at the end of the year.**

So while the income range was perceived as easier to deal with (especially amongst those with low incomes and low financial confidence), the uncertainties about accuracy and the need to make adjustments at year end **resulted in most saying they would undertake a part-year income calculation anyway as a failsafe to check the figures.**

**Subsequently, while the part-year income calculation was potentially more complicated and time consuming, it provided self-employed claimants with a greater sense of certainty that the income figures they were submitting were more likely to be accurate.**

### **Stopping tax credits process: *completing a part-year income calculation from the agent/intermediary perspective***

Agents and intermediaries highlighted some potential challenges with the part-year requirement.

#### **Ability to meet the deadline:**

- Concern that the 28 day deadline was too short:
  - clients may have incomplete records increasing the time taken to undertake the calculation
  - uncontrollable delays occurring due to client inefficiency, holidays and postal delays
  - being overwhelmed by an influx of clients all requiring an in-year tax credits calculation at one time

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<sup>1</sup> The income range reflected the disregards that currently apply to tax credit claims.



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Three months was perceived as a more realistic and feasible deadline.

### Understanding of the requirement:

- Concern that some of their clients would not understand what was being asked of them e.g.: self-employed claimants whose first language was not English

**Agents** expected that their **regular** clients would ask them to undertake the part-year calculation and most were willing to do the calculation for them.

However, there were mixed views about whether they would charge:

- some **would charge** as it would mean extra work
- some **would not charge** as it would save them time at year end

### **Stopping tax credits process: reactions to providing an income range from the agent/intermediary perspective**

**Agents and intermediaries** had questions around the potential for over and under payments.

If HMRC adopted the income range approach, they advised that any communications to self-employed claimants would need to explain:

- how the income range was calculated
- what self-employed claimants needed to do if their income was outside the specified range

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### *Understand what advance information self-employed claimants will require and when*

Overall, self-employed claimants wanted clarity about when to cease contacting HMRC about tax credits and when to start contacting the Department of Work and Pensions (DWP) about UC.

Otherwise they were likely to use HMRC as their first port of call for both tax credits and UC information.

They expressed a need for clear signposting, sooner rather than later.

### *Information needs by self-employed claimant type*

**Inexperienced with SA / those represented by an agent** - likely to seek support from HMRC both to explain the part-year calculation and to answer wider questions about Universal Credit.

**Low income self-employed claimants** - likely to seek clarification from HMRC regarding 1) changes to their benefit payments and 2) payment dates when tax credits stops.

### **Self-employed claimants with very variable incomes:**

- **Seasonal workers** - likely to seek clarification from HMRC to explain any potential impact of providing a part-year income calculation eg: any financial loss due to the variability of their working patterns
- **Complex/multiple sources of income** - likely to seek support from HMRC to explain how the part-year income calculation will work in practice and any potential impact eg: any financial loss due to outlays which fall outside the part-year timeframe

### *Establish areas of particular challenge, where customers may turn to intermediary organisations or to paid agents for assistance*

**Represented customers** said they would seek support from their agent with the part-year income calculation unless the cost of doing so was greater than their tax credits award.

### **Agents**

Practising agents said they expected to spend time researching the tax credits finalisation requirements in order to provide support to both their internal staff and clients during the transition via a variety of channels (face to face, phone, or through content on their websites).

In order to prepare themselves they asked for clear guidance from HMRC on:

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- information requirements overall
- any differences in the requirements for reporting income information within the tax credits current system and under the future Universal Credit system

Agents were keen to have this information sooner rather than later.

Large accountancy firms and professional bodies were planning to develop training events or materials for smaller agents and their members to clarify the requirements. These organisations said they needed significant advance warning about the transitional requirements and likely roll-out timescales to allow them to filter this information through to their members.

### **Voluntary and Community Sector (VCS) organisations**

VCS organisations (that provided advice about financial matters) planned to create guidance notes about stopping tax credits (and the transition) and to carry out internal training to ensure their staff were able to support self-employed claimants to complete a part-year calculation.