



European Employment Observatory

EEO Review: Self-employment, 2010

United Kingdom

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1. Introduction

Self-employment is a well established part of the UK labour market. The latest information (February-May 2010) from the Labour Force Survey (LFS) shows that there were 4 227 000 people classed as self-employed, representing 14.6 % of all those in employment. Since December 2007 (which proxies the start of the recession) the numbers of self-employed have actually increased by a modest 47 000 or 1.1 %, though the figures are much stronger than the corresponding fall of 3.3 % in the number of employees in employment. Whether this indicates that self-employment has been seen as an alternative refuge for those displaced from regular jobs by the recession is hard to tell, though it is likely that some of those losing their jobs did move into self-employment.

It is important to consider the official definition of self-employment as this dictates the appropriate treatment of the individual for income tax and national insurance purposes. According to government sources¹, to be legitimately considered self-employed, the following criteria should be fulfilled:

- run your own business and take responsibility for its success or failure;
- have several customers at the same time;
- can decide how, when and where you work;
- are free to hire other people to do the work for you or help you at your own expense;
- provide the main items of equipment to do your work.

Some of these points are aimed at differentiating between properly self-employed people and those who have been released by employers to work on their own but are essentially still working for their original employer – a trend that has increased with the development in IT and remote working.

Self-employment can take a number of legal forms in the UK, the three most common of which are as follows:

- sole trader – where the self-employed person works on their own account;
- partnership – where two or more persons are involved in the business;
- limited company – where the company is registered and has at least one shareholder.

In addition, self-employed status can also be accommodated under the following arrangements:

- co-operative – where the business is collectively owned and controlled by the people who work in it;
- franchise – where the person(s) have a right to run a branch of a business that is owned elsewhere.

These different categories are important as they also have tax and national insurance implications.

¹ More information is available at internet:

http://www.direct.gov.uk/en/MoneyTaxAndBenefits/Taxes/WorkingAndPayingTax/DG_4015975

2. Assessment of national labour market policies and recovery measures

The general approach to self-employment by UK governments is that it is something to encourage, though mainly by creating a climate whereby starting up is relatively easy, with the minimum of costs and bureaucracy, and for the most part this is the case. Someone starting up as self-employed is required to register this for income tax and national insurance purposes with HM Revenue and Customs, which can be done online, by telephone or post. There is no registration fee and minimal paperwork. For some types of business where regulation is important, it may be necessary to apply to a local authority for a licence – such as in the case of restaurants, childminding, taxi driving or street traders and here a fee may be payable.

Once registered, the self-employed person will have to consider a few other key issues that may not be familiar if they have been in the world of an employee. The main decisions revolve around the following things.

- i. Income tax – self-assessment with annual returns is required but for a sole trader or a partner it is based on the normal tax rates for those on Pay as You Earn (PAYE), with the added benefit that the self-employed can set expenses incurred in connection with the business against tax. Those self-employed with limited company status have to pay corporation tax which for small businesses is currently 21 % of profits. Shareholders can also take money out of the business in the form of dividends and these are taxed using a system with three rates².
- ii. Value Added Tax (VAT) – self-employed persons can opt to charge VAT on any amount of earnings they have, but it becomes compulsory once their income has reached the registration threshold (currently GBP 70 000, EUR 82 965). The disadvantage of registering is that prices charged are 17.5 %³ higher than they would otherwise be, so creating a potentially disadvantageous competitive situation. However, the advantage of being registered is that the person can reclaim any VAT paid on purchases made in connection with the business.
- iii. National Insurance (NI) – the self-employed are required to pay Class 2 NI contributions⁴ which are currently GBP 2.40 (EUR 2.85) per week (with exemption for those earning less than GBP 5 075, EUR 6 016 per annum). In addition, most self-employed will have to pay Class 4 NI on their profits (earnings) and this is effectively income tax in a different form (but is paid in addition to any income tax due and is collected through the self-assessment system). The current rate is 8 % of profits to a limit of GBP 43 875 (EUR 51 995) per annum, with a 1 % contribution on profits above this limit.

² These rates are currently 10 % on dividends below £37 400 per annum in value; 32.5 % for those between £37 400 and £150 000; and 42.5 % above £150 000

³ The Emergency Budget in June 2010 announced that the standard rate of VAT would increase to 20 % from January 2011.

⁴ Generally those paying National Insurance Class 2 contributions will not qualify for contributions based Jobseeker's Allowance (JSA) though they can claim income based JSA – which is essentially means tested.

2.1 Support for business start ups

The UK has an established single service approach to providing support to new business start ups and existing small and medium sized businesses. Known as Business Link⁵ in England, Business Gateway⁶ in Scotland and Flexible Support for Business in Wales (see Box below for further details), they offer an array of advice and guidance that includes help with developing a business plan (essential if start up capital is required) and training courses for before and after a business is underway. Funding is always an issue with new start ups and Business Link and its counterparts can prepare the aspirant self-employed person to apply for loans from the usual sources (high street banks in the main) but often access to grants and soft loans is limited – though in Wales the situation is somewhat better with its Single Investment Fund and Local Investment Fund (see Box below).

Flexible Support for Business in Wales

The Welsh Assembly Government (WAG) has developed a comprehensive support package – ‘Flexible Support for Business’ – particularly aimed at new start ups and including those moving into self-employment. There are three main elements:

- access to information and support
- relationship management
- funding and specialist support

A particular feature of the package on offer is accessibility to sources of funding – always a difficult area for new start ups, especially so for those moving from unemployment. Here there are two funds the first of which – the Single Investment Fund – is available for capital investments in excess of GBP5 000 (EUR 5 928) and is available throughout the country. The funding can be spent on capital, used for revenue purposes, for research and development and training.

In the ‘Convergence Area’ of Wales – this is the area designated as eligible for European Structural Funds - additionally there is the Local Investment Fund for capital projects under GBP 5 000 (EUR 5 928) in value which is seen as particularly relevant to those moving into self-employment but perhaps lack the necessary tools and equipment to get underway.

More information is at internet:

<http://fs4b.wales.gov.uk/bdotg/action/detail?site=230&r.s=sc&r.l1=5001392897&r.lc=en&r.l3=5001457679&r.l2=5001561569&type=RESOURCES&itemId=5001457744>

⁵ For more information see internet:

<http://www.businesslink.gov.uk/bdotg/action/layer?r.s=tl&r.lc=en&topicId=1073858805>

⁶ For more information see internet:

<http://www.bgateway.com/bdotg/action/layer?site=202&topicId=1073858805>

2.2 Policies supporting self-employment start-ups

While there have been efforts to create a climate where starting up as self-employed is relatively easy, there have been few specific labour market measures providing direct encouragement. The small number that have been introduced have tended to be geared to the unemployed and form part of general programmes aimed at helping people to get back into the labour market. The current support measures are listed below.

- i. New Deal Plus and Flexible New Deal⁷ – the unemployed aged over 50 who have been claiming Jobseeker's Allowance (JSA) for at least 12 months (or in some cases six months) can get help to become self-employed in the form of advice and guidance – initially through their personal adviser at Jobcentre Plus but subsequently directed to specialist advice - and some financial assistance but mainly in the form of the Government Self-Employment Credit.
- ii. Government Self-Employment Credit – this is aimed at helping the newly self-employed when they have been used to receiving Jobseeker's Allowance. The credit available is around GBP 50 (EUR 59) per week provided that the activity of self-employment lasts at least 16 hours per week and this is backed up with advice and guidance in the first few months of going solo. Clearly this can provide a useful income as a new business venture gets underway but the level is set very low and at a flat rate (though persons may be eligible for other welfare benefits depending on their family circumstances).

In addition, there is the advice and guidance support available through Business Link and its counterparts in Wales and Scotland, already discussed above.

2.3 Emergency Budget

The new coalition government introduced its Emergency Budget on 22 June 2010⁸ in an attempt to tackle the burgeoning budget deficit. The emphasis in the measures announced is on combining a reduction in public expenditure and increasing revenue (in a ratio of approximately 80 % and 20 %, meaning that the emphasis is very much on cuts) over a five year time horizon. The prospect of significant job losses in the public sector (and possibly through knock-on effects in the private sector) are real and so perhaps self-employment was seen as a possible route for some of those being displaced. This may help explain a number of new measures announced in the budget aimed at business start ups, as follows:

- entrepreneurial Relief – the 10 % relief rate for entrepreneurial activities will be extended from the first GBP 2 million (EUR 2.4 million) to the first GBP 5 million (EUR 5.9 million) of qualifying gains made over a lifetime;

⁷ New Deal Plus and Flexible New Deal are operating in parallel at the present time but in different areas. They essentially offer the same degree of support for those moving into self employment from unemployment and the expectation was that Flexible New Deal (which, as the name suggests, offers a more customised approach to support for the unemployed) would eventually be rolled out nationally. However, following the change in government in May, the programme is likely to be stopped and new approaches introduced, though the timing of this is uncertain.

⁸ The details of the budget are at internet: http://www.hm-treasury.gov.uk/d/junebudget_complete.pdf

- finance for start-ups – the government will extend the Enterprise Finance Guarantee Scheme⁹ to provide GBP 200 million (EUR 237 million) in extra lending to small businesses until 31 March 2011;
- corporation tax for small businesses – this will be reduced from 21 % to 20 % from next tax year;
- Job creation scheme – over the next three years, new businesses outside London and the South East of England will be exempt from up to GBP 5 000 (EUR 5 928) in National Insurance contributions for the first 10 employees recruited in an effort to help create jobs in the areas of weaker employment growth.

Taken together the extra public expenditure on these measures is small but nevertheless, it does show a commitment to encouraging start ups and the small business sector in general.

However, other changes have been announced by the new government that could affect the support available to those starting out as self-employed. The Regional Development Agencies (RDAs) in England are to be abolished – principally as a cost saving measure – and in their place will be Local Enterprise Partnerships (LEPs) that are expected to carry-on much of the work of the RDAs but at lower cost (relying a great deal on voluntary participation) and for smaller economic areas (so, for example, they could cover a large city). However, within all this, the position of Business Link looks precarious and it seems unlikely that the service will survive as a whole; rather the services they currently provide to businesses (start ups and established ones) will be expected to be adopted by the new LEPs.

3. Quality of self-employment jobs

There is no single source of information on the relative quality of self-employment jobs – particularly in comparison to employees. In fact, evaluative research in general on self-employment in the UK is limited. This may reflect the low profile of self-employment in economic and labour market policy – it has never been seen as a major player in tackling unemployment, for example – and it may also be attributable to the difficulties in accessing information from the self-employed themselves who, by the very nature of their role, are independent and sometimes hard to track.

However, it is clear that self-employment does not represent an easy option, as indicated by the Labour Force Survey (LFS) figures on the usual weekly hours of work. The latest figures (February-May 2010) show that around 30 % of the self-employed claim to work in excess of 45 hours per week, compared to just 18 % of employees in employment. For men the percentages are 36.5 and 25.7 and for women, 16.0 and 9.2 – the latter reflecting the high incidence of part-time working in the female labour force. A study by Bell and La Valle (2002) on self-employment and family life confirmed these long hours – but for fathers rather than mothers. It found that 41 % of self-employed fathers worked over 48 hours a week, rising to 59 % where fathers had employees in their business. On the plus side it did allow

⁹ The Enterprise Finance Guarantee Scheme was introduced during the difficult trading conditions under the recession and under it the government guarantees lending to viable businesses for working capital and investment purposes. More details are at internet:
<http://webarchive.nationalarchives.gov.uk/+http://www.berr.gov.uk/whatwedo/enterprise/enterprisesmes/info-business-owners/access-to-finance/efg/page37607.html>

more atypical flexible working for parents and this was often behind the decision of mothers to go self-employed, but not so much for fathers.

An interesting (but albeit old) study by Kellard et al (2002) explored the take up of self-employment by the registered unemployed and found that overall around 8 % of the unemployed moved to self-employment and it was highest for those on New Deal 50 Plus at 9.4 %, compared to 4.6 % for those on New Deal 25 Plus. Benefit leavers tended to become sole traders in low capital, labour intensive businesses and had low earnings but worked long hours. The report also found that some form of wage supplementation and access to credit was vital for a sustainable period of self-employment, but ongoing advice and guidance was also important.

The self-employed also lose out when it comes to periods of unemployment. As mentioned above, the National Insurance Class 2 contributions paid by the self-employed do not give entitlement to contributions based Jobseeker's Allowance (JSA) (which is paid at fixed rates for up to 26 weeks), and receipt of the alternative income based JSA is means tested on income and savings.

In terms of income, a recent study by Allinson et al (2010) confirmed the perception that the self-employed do worse than their employee counterparts. It found that self-employed business owners earned, on average, a lower income than that achieved in conventional employment. Younger owners in particular lost out, working longer hours for less money, took more risks (in the business sense) and had a lower level of savings and fewer alternative sources of income.

Another often overlooked area where the self-employed tend to lose out is in pensions. A study by Sainsbury et al (2006) examined the situation of a sample of self-employed people – most of who had moved into working for themselves from previous jobs as employees. This meant that they lost their comparatively generous occupational pension schemes and so had to take responsibility for setting up and contributing to their own private pensions. This invariably meant that they would end up with a much smaller pension than if they were employees and some were expecting to have to exist on the state pension alone (which is among the lowest in the EU) while others were relying on their property to provide an income. One interesting effect of this reduction in pension expectations was that many of the self-employed were not expecting to retire at the normal retirement age.

In general, the self-employed are not officially classed as 'employees' or 'workers' and so fall out of scope to most of the regulatory framework of the labour market – such as the national minimum wage, equal pay, holiday entitlement, limits on working time, etc. Furthermore, it is difficult to see how this legislation could be extended to the self-employed or, if it was, how it would be enforced. The key elements of flexicurity are, in practical terms, problematic for the self-employed.

In terms of the abuses of the status of self-employed, as mentioned earlier, the main issue is cases of 'dependent' self-employment where a person may effectively work for just one employer. This is thought to be more prevalent in some sectors – especially construction where anything up to two-thirds (see Harvey 2001) of those classing themselves as self-employed may be dependent on one employer for their work. However, there are no data

available on this, although HM Revenue and Customs have been trying to stop such practices over the past few years.

4. Conclusions

In the UK, self-employment has held up comparatively well during the recession and has no doubt provided an alternative employment status for some displaced by restructuring. The regulatory framework for setting up as self-employed is straightforward and low cost, but while the self-employed are expected to pay much the same tax and national insurance as their employee counterparts, they tend to fall out of scope to much of the employment protection legislation such as the national minimum wage, working hours and equal pay and also lose out when it comes to representation of their interests by trade unions. It may therefore be difficult to understand the motivation for becoming self-employed but the advantages of freedom from the constraints of an employer, the greater ability to adapt work to lifestyle and the retention of any profits made are often cited as the key factors.

In terms of the objectives of flexicurity, it would seem that the self-employed have a high degree of flexibility but very little security in their work but at the same time, it is difficult to see how the main tenets of employment protection legislation can be applied to a person who, by definition, is responsible for their own actions.

Finally, the amount of research on the self-employed in the UK is low and this clearly inhibits understanding of their motivation and problems and their attitudes to regulation. The recently announced severe cuts in public expenditure will highlight the option of self-employment more and so it would be valuable to initiate further study to help understand and promote this employment route in the most effective way.

5. Bibliography

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