



Self-employment and Universal Credit

A detailed guide for advisers

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Self-employment and Universal Credit – A guide for advisers

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Section 1 - What counts as self-employment for UC?

For UC purposes, earned income includes the remuneration or profit derived from a trade, profession or vocation. This remuneration or profit will be treated as self-employed earnings for UC.

According to the DWP ADM ([Chapter H4](#)), the concept of 'trade, profession or vocation' is taken from tax law. A person will either be a sole-trader or in a partnership with other(s).

The ADM includes a list of items that should be taken into account when determining if a person is engaged in a trade. No one point is exhaustive. In some circumstances the existence of one point may be enough in others it will be a combination of factors. We have reproduced the factors to be considered below. Paragraph H4013 contains useful examples of how the criteria will be applied:

- 1. whether there is a profit seeking motive (Regardless of whether or not a profit is actually made)*
- 2. the frequency and number of similar transactions. The more frequently that a transaction is carried out, the more likely that this is trading*
- 3. whether assets are modified in order to make them more attractive for a person to buy. If this is the case then this is likely to point towards a trade.*
- 4. The nature of the asset – was the asset bought simply to sell on for a profit?*
- 5. Whether there is a connection with an existing trade. If a person sells something unconnected with what they normally do by way of work then this may point towards a person not trading*
- 6. Financial arrangements. Where an asset is bought with a short-term loan which is to be funded by selling the asset again then this points towards trading*
- 7. The length of ownership. The longer than an asset is owned, the more unlikely that the sale of it constitutes trading.*
- 8. The reason for the acquisition and sale.*

Guidance on what constitutes a profession and vocation is less detailed. Examples of a profession include accountancy, the law and consultancy. Examples of a vocation given in the ADM include sport, music and acting.

The profession and vocation must be carried out in a capacity other than an employed earner.

Section 2 - Calculating income from self-employment

Calculating income from self-employment for UC is very different to tax credits where claimants simply take the figure used for their tax return and enter it on to the tax credits forms.

Income from self-employment will be taken into account regardless of whether the person is found to be in gainful self-employment or not.

Section 2.1 - General rules

Earnings that are not [employed earnings](#) and are derived from a trade, profession or vocation are self-employed earnings.

Self-employed earnings must be calculated for the claimant's [monthly assessment period](#).

The basic calculation is:

GROSS PROFITS minus INCOME TAX, NATIONAL INSURANCE AND PENSION CONTRIBUTIONS

Whilst this seems a straightforward calculation, there are some important points to bear in mind:

- Gross profits are defined as 'actual receipts' minus 'permitted expenses'
- The income tax that can be deducted is the actual amount paid to HMRC in the UC assessment period. A strict reading of the Regulations means that only tax due on income from that particular trade, profession or vocation can be deducted. In practice this will be difficult to calculate for claimants who have more than one source of income that is dealt with through self-assessment without further guidance from DWP.
- Class 2 and 4 contributions paid in the UC assessment period can be deducted, again these must be paid in respect of the 'trade, profession or vocation'.
- Pension contributions must be 'relievable'. This means they must be paid to a registered pension scheme by or on behalf of a member of the scheme. The contribution must be paid by a 'relevant UK individual' and certain contributions are specifically excluded. More details can be found in [Paragraph H4124](#) onwards of the ADM. The same pension contributions may not be deducted from self-employed earnings if a deduction has already been made in calculating the claimant's employed earnings.

Section 2.2 - Actual receipts

Any payment actually received during the assessment period is included as an actual receipt, regardless of when it is earned. -

Actual receipts include

- Any payments for goods and services provided – cash, cheque and credit card payments received in return for goods and services
- Earnings payable abroad – money that is due to be paid to a business in a country outside the UK should be included when it is received by the business
- Personal drawings – if personal drawings have been deducted from the amount shown as an actual receipt, the amount should be added back in
- Sale of certain business assets – the amount received from the sale of a capital asset should be included only where the asset was part of the stock in trade of the business
- Tips and gratuities – where received in response to the service being provided, these should be included as actual receipts but not where they are made as a gift on personal grounds and unconnected to the self-employment
- Payments in kind – DWP will decide an equivalent monetary value to include in the actual receipts
- Any VAT receipts
- Refund or repayment of income tax or national insurance contributions

The [ADM Chapter 4160](#) onwards provides further details about each of these payments, together with some examples.

Section 2.3 - Permitted expenses

Permitted expenses are amounts paid in the assessment period in respect of expenses wholly and exclusively incurred for the purposes of the trade, etc, or an identifiable business proportion of any expenses incurred for more than one purpose. In principle, DWP will deduct from the actual receipts any business expense that

- was paid out wholly and exclusively for the purposes of the business, and
- was paid out during the assessment period, and
- was reasonably incurred, and
- is an allowable expense,

The [ADM Chapter 4197](#) lists allowable expenses and provides more details about these conditions.

Flat-rate deductions are allowed as follows:

- for acquisition and use of a motor vehicle, based on mileage per month:

For a car or van	for the first 833 miles	45p per mile
	thereafter	25p per mile
For a motor cycle		24p per mile

Note that for a car, the *only* deduction allowed for the cost of acquiring or running the vehicle is the flat rate deduction. In the case of a motor cycle or van, the claimant may choose between the flat rate deduction (above) or the actual cost of acquiring and running the vehicle under the permitted expenses rules.

- for the use of the claimant's home for business purposes, depending on the number of hours spent in an assessment period on 'income generating activities' relating to the trade, etc

At least 25 hours but no more than 50 hours	£10
More than 50 hours but no more than 100 hours	£18
More than 100 hours	£26

- for use of business premises where there is also some personal use, the actual cost in the assessment period minus:
 - £350 where only one person is occupying the premises partly for personal use
 - £500 for two persons
 - £650 for three or more persons

Expenses not allowed include:

- any expenses 'incurred unreasonably',
- expenditure on non-depreciating assets (including property, shares or other assets held for investment purposes),
- any loss incurred in respect of a previous assessment period (nor any concurrent loss from any other self-employment),
- repayment of capital in relation to a loan taken out for the purposes of the trade, etc, (loan interest can be deducted up to the total value of £41 in each assessment period)
- expenses for business entertainment, and

- some flat-rate deductions

Section 2.4 - HMRC cash basis

Claimants will be asked to provide evidence of their self-employed earnings. As accounts are generally prepared using accounting principles, they will often show different information to that required for UC purposes and claimants may therefore be asked to provide additional supporting evidence, such as bank statements, purchase receipts or indeed expenses from a different assessment period, to support their claim.

Providing self-employed income calculated on a cash basis for UC purposes present complications for claimants as there are key differences between the accounting mechanisms for income tax purposes and those for UC purposes, outlined below:-

	Accounting under Universal Credit	Accounting under HMRC's cash basis
Reporting time frame	Monthly reporting.	Annually by January 31 after the end of the tax year
Mandatory or optional use of accounting basis	There is no choice on how the monthly accounts are prepared for DWP – they must conform to the Universal Credit regulations.	The cash basis is optional and businesses can elect to use it on an annual basis. Alternatively businesses can use the 'accruals basis' (generally accepted accountancy practice).
Thresholds	There are no thresholds – all self-employed Universal Credit claimants must use the same accounting basis.	Universal Credit claimants must leave the cash basis if their annual turnover is greater than £154,000 (twice the VAT registration limit)
Transitional rules	There are no transitional rules; when completing their self-assessment tax returns Universal Credit claimants must adjust their annual accounts to ensure that income and expenses are only declared once.	On switching to the cash basis (and from it to the accruals basis), transitional rules ensure that income and receipts are accounted for only once.

Carry forward of losses	There is currently no facility to carry forward losses from one assessment period to another.	Business losses may be carried forward to set against the profits of future years but not carried back or set off 'sideways' against other sources of income
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Section 3 - Reporting income from self-employment

Claimants must report their self-employed earnings for the assessment period up to 7 days before and 14 days after the end of the assessment period. It is likely that this will be online reporting although there should be other options for those who cannot report online.

Reporting self-employed earnings on time is very important. Failure to do so can lead to UC payment being initially suspended and then terminated if earnings are still not reported within a calendar month of the cut-off date.

Section 4 - Gainful self-employment

A claimant is in *gainful self-employment* if the Secretary of State has determined that they are carrying on their activity as their main employment, the earnings from it are genuinely self-employed earnings, and it is organised, developed, regular and carried on in expectation of profit.

Whether a claimant is in gainful self-employment for UC purposes is important because it may have an impact on the claimant's [work-related requirements](#) and it also determines whether:

1. minimum income floor applies to the claimant's S/E earnings
2. the claimant is eligible for a start-up period (see below).

The claimant will be asked to provide evidence of their self-employed activities usually at a 'Gateway' interview shortly after the UC claim has been made.

There are important factors to be considered carefully, for instance, how long the business has been running, whether it is a new business or long-established, how much income is received from the business, that work is done in expectation of profit, how much work is in the pipeline and so on. This list is not exhaustive and while the determination of gainful self-employment will often be straightforward, there are many cases where several factors need to be weighed up to reach the correct conclusion.

[ADM Chapter 4020](#) provides more information about how DWP will determine whether someone is in gainful self-employment.

Section 5 - Minimum income floor (MIF)

Section 5.1 - How the MIF works

For UC purposes, if a person is in *gainful self-employment* in an assessment period, and their earned income (ie their gross profits along with any employed earnings) in that assessment period amounts to less than a minimum amount (the *minimum income floor, MIF*), they are treated as having earned income equal to the MIF.

The amount of the MIF is, very broadly, equivalent to the national minimum wage for each hour that the claimant is expected to work – usually 35 hours a week). From that is deducted a notional amount to reflect the income tax and national insurance for which the claimant would be liable if they had earned income of that amount. Note however that there is currently no deduction allowed from the MIF for pension contributions meaning that those who are subject to the MIF in reality will not get a true deduction for their pension contributions as their employed counterparts will.

Example

Jack is a 30 year old window cleaner who works full time in his trade. His individual earnings threshold (ie the minimum wage for the number of hours the claimant is expected to work) is based on the national minimum wage of £6.31 an hour for a 35 hour week:

$$£6.31 \times 35 = £220.85 \text{ per week}$$

His minimum income floor for any assessment period, using current figures, should therefore be:

$$(\text{£}220.85 \times 52)/12 = \text{£}957.02 \text{ minus notional tax and NI (say £71) = £886.02}$$

Where a claimant is a member of a couple, and the claimant's gross profit for an assessment period is lower than the MIF, then the MIF only applies to the extent that the earnings of

the couple taken together do not amount to the couple's combined earnings threshold. The earnings threshold, broadly, is the number of hours both members of the couple are expected to work times the national minimum wage. Where the couple's earnings exceed the couple's earnings threshold, the MIF for the self-employed partner is reduced or eliminated accordingly.

Example

Jack's self-employed earnings for assessment period A are £600. His wife Jill is employed full-time in a bank and earns £15,000 a year (say, net earnings of £1,085 a month). The combined earnings threshold of the couple for a month is, say, £1,772.04 (35 hours a week each at the NMW of £6.31 an hour, less tax and NI). Their actual combined earnings are $£600 + £1,085 = £1,685$

Applying Jack's MIF of £886.02, their combined earnings for the month would be $£1,085 + £886.02 = £1,971.02$, which exceeds their combined earnings threshold by $£1,971.02 - £1,772.04 = £198.98$.

Jack's MIF is therefore reduced as follows: $£886.02 - £198.98 = £687.04$.

Section 5.2 - Problems with the MIF

The MIF, and other aspects of the way self-employed earnings are calculated for UC, potentially present several problems for those who are starting out in business.

- Because the 'start-up' period is set at 12 months, where a business takes longer than 12 months to become profitable, the MIF will distort its results, particularly when combined with the prohibition on carrying forward losses from one assessment period to the next.
- The deduction of a notional amount of tax and NI each month to arrive at the MIF conflicts with the fact that tax on self-employed earnings is actually paid twice a year. HMRC do offer a Budget Payment Plan for people to pay their self-assessment bills, however there are certain rules attached to this. More information can be found on the [HMRC website](#).
- Unless a business is very profitable, the tax bill when paid each January and July could by itself depress earnings in those assessment periods, to the extent that the MIF is applied when it might not otherwise have been.
- The above point also applies in any month in which an annual or one-off debt/bill was paid (such as an insurance premium) and deducted from one month's trading receipts.
- Businesses will have to account each month for their 'profits' on a cash basis in line with UC rules, which differs in key respects to the more familiar cash basis accounting rules introduced for the year 2013/14 for tax purposes, necessitating two sets of accounts. This could potentially deter would-be entrepreneurs from claiming universal credit, or from pursuing the self-employed option at all.

Section 5.3 - Exceptions to the MIF

There are three situations in which the MIF does not apply at all:

- (1) where the assessment period in question is in or overlaps with the beginning or end of a *start-up period* (broadly, the first 12 months of trading, of which a claimant is allowed only one every five years (reg. 63)), or
- (2) where the claimant is subject to no work-related requirements (ie they are not required to work rather than have sufficient income to put them in this group), or is subject to a work-focused interview requirement or a work preparation requirement only.
- (3) Where the claimant is not gainfully self-employed

More information about the Minimum income floor, together with examples, can be found in [ADM Chapter 4060](#).

Section 6 - Partnerships and sub-contractors

Partners are similar to sole traders, except that ownership and control of the business is shared between two or more people. People can enter into a partnership under an agreement that may be written, for example a deed of partnership, verbal or implied. A partnership can also happen by operation of law without necessarily any intent to form a partnership. A deed of partnership includes details of how any profit or loss is shared between the partners. In the absence of an agreement any profit should be shared equally among the partners.

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

Example

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

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

Both of these are treated as types of self-employment.

More information can be found in [ADM Chapters 4330 and 4350](#)

[Section 7 - Companies](#)

Where a person or persons carry on a trade or property business through the medium of a company, they are treated as the sole owner of or a partner in the trade or business for UC purposes. For tax purposes, companies are subject to specific rules and pay corporation tax which is a different system to the HMRC cash basis outlined above for the self-employed. The following consequences apply, except where the person is working for an IR35 type intermediary company or managed service company (ITEPA 2003, Part 2, Chapters 8 and 9):

- The person is treated as possessing capital equal to the value, or their share of the value, of the capital of the company (the actual value of their holding in the company is irrelevant), but any assets of the company that are used wholly and exclusively for the purposes of the trade are disregarded while they are being so used.
- The income of the company, or that person's share of the income, is treated as the person's own self-employed earnings, and liable to the MIF where their business is their main employment.
- Any employed earnings the person receives as a director or employee of the company are added to their deemed share of the company's income.

[ADM Chapter 4360](#)

Appendix A - Summary of differences between tax credits and UC

There are several notable differences between the established tax credits system and the new Universal Credit system in the treatment of claimants who are self-employed. Many of these differences will mean claimants who have become familiar with tax credits will need to particularly pay close attention to the rules for UC, to ensure they receive the correct award and can consider making their own provision to support them through some of the more restrictive changes.

The table below outlines the main distinctions:-

	Tax Credits	Universal Credit
Treatment of losses	Losses can be offset against the total household income in the first year and any remaining loss not used up this way can be offset against income from the same trade or profession in subsequent years	No deduction is allowed for losses.
Reporting timeframe	Based on annual income, reported annually, by 31 January after the end of the	Income must be reported every month, within 7 days of the end of the assessment

	tax year (optional – can be done more frequently if wide fluctuations anticipated on figure already held)	period
Allowable expenses	Purchase costs of motor car allowed and interest on business loans. Reasonable Business entertainment expenses allowed. Income Tax and National Insurance are not allowable expenses	Interest on business loans only allowed up to £41 in any assessment period. Purchase cost of motor car not allowable expense. No business entertainment expenses allowed. Income Tax and National Insurance are allowable expenses within the monthly assessment period in which they are paid.
Other income, including property income	Income from property is treated as other income and subject to the 'Other Income' £300 disregard	Income from property included, no specific disregard other than permitted expenses
Minimum Income Floor	Only actual income earned, calculated annually, is taken into account as trading income and losses are taken into account.	If income is below the personal threshold (including where the business makes a loss) in a monthly period then this artificial income level applies to those who are gainfully self-employed (after the 12 month start-up period).
Thresholds	Claimants must leave the cash basis if their annual turnover is greater than £154,000 (twice the VAT registration limit)	There are no thresholds – all self-employed Universal Credit claimants must use the same accounting basis.
Mandatory or optional use of accounting basis	The cash basis is optional and businesses can elect to use it on an annual basis. Alternatively businesses can use the 'accruals basis' (generally accepted accountancy practice).	There is no choice on how the monthly accounts are prepared for DWP – they must conform to the Universal Credit regulations.
Income	Income receipts do not include refunds of income tax and national insurance.	Income receipts include refunds of income tax, national insurance and VAT.

[Appendix B - Legislation and Guidance on self-employment](#)

The main detailed guidance about self-employment under Universal Credit can be found in the DWP's ADM, [Chapter H4](#).

The main legislation for self-employment is in the Universal Credit Regulations, [SI 376/2013](#). You can find all legislation relating to Universal Credit on [Revenuebenefits](#).

[Chapter 2, Reg.51](#) et seq. provides the introduction to the general principles covering 'earned income', with the main regulations covering self-employed earnings in particular found at [Reg. 57](#) et seq.

DWP have also produced a [factsheet](#) providing information for claimants and their advisers on self-employment and UC.