Social Security Advisory Committee Consultation – Universal Credit (Surpluses and self-employed losses) Regulations 2014
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome this opportunity to respond to the Social Security Advisory Committee's consultation. Given the potential consequences of these regulations, both for the employed and self-employed, we are extremely disappointed that the Department for Work and Pensions (DWP) have not consulted wider.

1.2 Having considered the detail of the regulations, we are strongly against them being implemented in their current format and believe they will not only introduce unnecessary complexity and administrative problems to the system but they will have adverse effects on the self-employed that have not been fully considered by DWP.

1.3 The supporting documents do not contain any evidence that manipulation of income in the way shown in some of the examples is a real problem and in our view most employed claimants will not have such control over their income. We are not aware that such manipulation of income has been a problem in the current tax credits system and therefore the policy lacks justification. We believe that a better way to deal with potential manipulation is to have a general anti-abuse provision.

1.4 For those with fluctuating incomes, we believe that averaging of income provides a fairer and easier method of calculating income. DWP already have averaging regulations in place for the purposes of determining whether someone with a fluctuating income meets the conditionality threshold, therefore it seems sensible to apply the same measure. In our view, this will be far easier for DWP to administer than the suggested surplus earnings policy.

CHARTERED INSTITUTE OF TAXATION
1st Floor, Artillery House, 11-19 Artillery Row,
London, SW1P 1RT

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)20 7340 0550
Fax: +44 (0)20 7340 0559
E-mail: litrg@ciot.org.uk
www.litrg.org.uk

UK REPRESENTATIVE BODY ON THE
CONFEDERATION FISCALE EUROPEENNE

1.5 The surplus earnings policy is complex and we doubt that DWP will be able to explain it well enough to claimants so that they understand the need to budget in any period during which they are outside universal credit (UC). In addition, the rules for calculating the surplus are unfair in only taking into account income changes in intervening periods and not changes of circumstances, and are extremely complex for couples who separate and come together. The fine detail of the policy has been fixed to make it easier for DWP to administer rather than ensuring fairness for all claimants.

1.6 Perhaps one of the biggest concerns with the policy is its impact on the self-employed who do not have losses. The DWP have used examples to justify the policy in relation to the employed, however if those same examples are worked through with self-employed people a completely different result is obtained. Firstly, the self-employed person with spikes in income obtains no benefit from having fluctuating income in the first place and secondly, they lose over £1000 of UC entitlement compared to an employed person earning exactly the same amount over a year when the surplus earnings policy is applied. This is despite assurances from Lord Freud that he would ensure parity between the employed and self-employed. It is concerning that DWP have not included any discussion or analysis of the impact of the policy on the parity between the two groups.

1.7 We welcome the recognition of losses for the self-employed, an area we have been pressing DWP to acknowledge for some time. However, the proposed solution is incredibly complex and difficult to understand and will increase administrative burdens on the self-employed in periods during which they are outside UC. Once again pension contributions have been disallowed in calculating losses, thus creating further disparity between the self-employed and employed.

1.8 The issue of fluctuating incomes for the employed and self-employed could be dealt with by a set of averaging rules. This would be fairer, easier for people to understand and would reduce administrative burdens for DWP.

1.9 The Minimum Income Floor (MIF) remains an incredibly harsh measure for the self-employed who fall on hard times or who have a large expense in a particular month. Having a MIF and a surplus earnings policy means that some self-employed people are even worse off than under the MIF system because the nature of their self-employment is to have fluctuating income.

2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 General comments

3.1 We welcome this opportunity to respond to the Social Security Advisory Committee's consultation on the UC (Surpluses and self-employed losses) Regulations 2014 ('the regulations').

3.2 We have not answered the Committee's questions specifically as some of the questions are outside the areas we have focused on, but we hope that the Committee will find the detail in our response helpful.

3.3 The regulations make fundamental changes to the design and structure of the UC system by eroding the concept of monthly assessment periods. They also add significant complexity to an already complicated system. It is disappointing that DWP themselves have not carried out any detailed consultation outside the department about the changes.

3.4 Although this response attempts to highlight some of the main areas we have concerns about, the short amount of time to respond to the consultation means that we have not had time to carry out detailed modelling and calculations which means there could be far greater consequences for the self-employed than we have identified here. It is crucial that DWP do some further analysis and modelling to look at how surplus earnings and loss relief work together in a variety of situations to ensure there are no adverse consequences and no disparity is created between the employed and self-employed.

3.5 Complexity is sometimes necessary in order to address a specific problem or issue. However, in respect of the surplus earnings proposals, we remain unconvinced that manipulation of the system in the way suggested will be likely or even possible for the vast majority of UC claimants. It therefore seems absurd to introduce such complexity for all UC claimants to stop a very small number who seek to manipulate. The papers do not put forward any convincing evidence suggesting there is a problem nor the scale of it. We think there are far better ways of addressing both potential manipulation and fluctuating incomes.

3.6 Turning to proposals for surplus earnings and losses for the self-employed, although there is a definite need for changes to the current UC regulations for the self-employed in relation to recognising losses, these new proposals are complex and do not work well with the MIF provisions already in place. In fact, as we explain in paragraph 5.2 below, the surplus earnings policy does not work in the same way as it does for the employed and this does not seem to have been considered at all in the explanatory memorandum (EM). It means that a self-employed person earning the same amount over 12 months as an employed person will end up with a significantly lower amount of UC. This surely cannot be the intended consequences of this policy.

3.7 Due to the complexity of the proposals, we believe that there will be significant costs to administer and communicate these policies. We believe that in both cases there are better ways of achieving the required results. For surplus earnings, this means ensuring that those who seek to manipulate the system are deterred from doing so and for the self-employed this means having a system of assessment that recognises fluctuations in income and expenses. We outline these proposals at the end of this consultation response.

3.8 We would also like to draw attention to paragraphs 4.4 and 4.5 of the Equality Analysis document. The policy will not be implemented until 2016 which means that some claimants who receive UC prior to 2016 will continue to be dealt with under the existing provisions (with no surplus earnings applied but with no access to loss relief). It is not clear what the potential impact of this is and how many people will be subject to the old rules from 2016. We do not think that it is fair to introduce a benefit that applies differently to people depending on when they joined, especially when the differences are significant. It also means that communications and guidance will be made more difficult.

3.9 Finally the EM states that the policy will be introduced from 2016 and that this will ensure time for households to prepare and adjust and enable the Department to test the right processes and communications to guide households and employers through this change. There is also discussion of the 'test and learn' approach to UC in the equality assessment. However, the equality assessment (page 7) also states that most of the people affected by surplus earnings will be those on higher incomes and while the self-employed will be affected by the other proposals, they will be among the later groups to transition to UC. We do not see how materials and guidance can be developed and tested if the people who will be affected most will not be coming through in the initial phases until 2016 when the policy is in place.

4 Surplus earnings policy - employed

4.1 *Rationale for the policy*

4.1.1 According to Paragraph 1.2 of the EM, the rationale for the surplus earnings policy is two-fold – to reduce the potential for manipulation and so that people with fluctuating earnings patterns are neither unduly penalised nor unfairly rewarded if they earned the same amount but were paid monthly.

4.1.2 As noted above, the EM does not have any supporting figures or evidence that suggests there is a large risk of manipulation. The current tax credits system has opportunities for manipulation in terms of earnings patterns to take advantage of the income disregard; however, HMRC have never stated nor indicated that this has been abused or been an area for concern. We therefore do not think that potential manipulation alone necessitates the introduction of such a complicated and unfair set of rules.

4.1.3 The EM states that the median amount of surplus earnings is around £200, meaning that half of all households with surplus earnings would have total surplus earnings of £200 or less. This suggests that many of these households will not be manipulating the system with large income spikes. Indeed, those who are setting out to manipulate the system can still do exactly the same thing providing they leave a gap of at least six months between payments.

4.1.4 The second reason given is to ensure that paid workers with fluctuating earning patterns are not unduly penalised or unfairly rewarded by receiving less or more UC that they would have had they earned the same amount but been paid in regular monthly payments. The obvious answer to this is to have a system of averaging. The EM states that the proposed policy is an attempt to address these issues that 'avoids the case by case insight required by the current benefit system to average and attribute earnings'.

4.1.5 However, we do not think this second reason is justified given that for conditionality purposes people with fluctuating incomes will have their weekly income averaged over a period of time (which may be different for each claimant depending on their work and patterns)[1]. This means that the department, in some cases, will already have an established mechanism to work out average earnings over a defined period in order to determine whether a person with fluctuating earnings will be subject to any conditionality. For this reason, as well as many others, we think averaging earnings for people with fluctuating incomes is an easier and less complex way of dealing with this problem given that the department will already be doing the relevant calculations.

4.2 ***Impact on UC claimants and behaviour***

4.2.1 We are extremely concerned that introducing this policy will have an adverse impact on behaviour and work incentives.

4.2.2 The EM states that 100,000 to 200,000 households are estimated to have a fluctuation in earnings that gives them surplus earnings in a given assessment period. However, this analysis has only been done on the basis of fluctuating earnings and does not seem to include situations where earnings are stable but the claimant's circumstances have changed. This would also lead to 'surplus earnings' and could mean the numbers are much higher.

4.2.3 Although the EM says that the number of households estimated are only a small proportion (2%) of the UC caseload, given the numbers of claims expected overall it is still a very

[1] Regulation 90(6) – Universal Credit Regulations 2013 (SI 376/2013)

significant number of people, many of whom are likely to be vulnerable and who will neither be manipulating income nor have fluctuating earnings patterns.

4.2.4 We are particularly concerned about claimants who do as the Government ask, find themselves a job that takes them off UC, and then change their outgoings to reflect the new position only to find some four or five months later that they are laid off or have their hours cut. These people may well be caught up by this policy which seems extremely unfair and is likely to discourage people from taking temporary jobs or extra hours if they know that the support they may need again is reduced. This means people would need to understand that they must budget not only for living in the months they are working, but also for the first five months of the new job to make provision should they fall back into the UC system. We have similar concerns about people taking zero-hour contracts who might be in a similar position with fluctuating income.

4.2.5 The policy is likely to force such claimants to have to borrow short term for a couple of months, potentially even driving them into the more unscrupulous end of the lending market, before coming back on to UC in order to avoid the surplus earnings being applied if they are significant. Worse still, they may find that they have nothing to live off for that period. There is a significant amount of work going on to reduce both public and personal debt and some huge strides are being made in educating people against getting into debt and yet these new regulations, if implemented, could force people to do more borrowing.

4.2.6 The examples in the EM, particular Example 1 (Barry and Paul) show the extreme end of the spectrum with Paul's payment patterns. There is no indication as to how many people DWP believe are paid in this way (either intentionally or otherwise).

4.3 ***Couples***

4.4 The operation of the surplus earnings policy in relation to couples, particularly those who have separated or formed a new unit, is perhaps one of the areas of greatest complexity. Having read the proposals, the draft regulations and the EM with examples, we have found it extremely difficult to understand how it works. Given that we are professionals who are used to dealing with complexity, we cannot see how a typical UC claimant will have any chance of understanding their current or future position and therefore be able to prepare or make adjustments to deal with it.

4.5 The proposals for how surplus earnings are to be apportioned for couples is extremely complicated and in part relies on DWP doing what is most advantageous for the couple in a given situation. We are concerned how this will be communicated to claimants in a clear and simple way or indeed how anyone can appeal or challenge a decision if they are not clear about how the calculation should in fact be done.

4.6 Examples 5 and 6 highlight the complexity of the policy in relation to couples forming and separating. It appears that in apportioning surplus earnings between couples who separate and form, they are apportioned based on earnings in the final assessment period of the old claim even though surplus earnings are a result of a combination of income and circumstances.

4.7 It also strikes us as unfair that when couples separate, their earnings are used as the determination of their surplus with no reference to circumstances including how finances are arranged between the couple.

4.8 It is likely to get more complex when people come together and separate with short time periods between each. It is likely to be confusing and difficult to administer as surpluses may need to be brought together and then separated with multiple partners potentially being involved.

4.9 ***Communications***

4.9.1 As noted above, we believe that there is a large amount of complexity within this policy. This will make it extremely difficult, if not impossible, to explain it properly to claimants so that they understand:

- The need to put money aside for the first five months of a new job in case they have to come back onto UC as surplus earnings may be taken into account (although not so much as to make them fall foul of the capital rules).
- How their surplus earnings are calculated, particularly in cases of separating or forming couples.

4.9.2 We have previously raised concerns about the information that will be shown on UC award notices. Our experience with the tax credits system has shown us that claimants find award notices extremely difficult to understand when they seek to explain more complicated figures. Any award notice will not only need to show the surplus used, but how this surplus was calculated in order to allow the claimant to challenge anything that they believe is incorrect. We think this will be a difficult task and will likely lead to a great deal of confusion which will result in more pressure on the UC helpline and other front-line services.

4.9.3 In addition to communications for claimants, DWP staff will need to understand the policy, as will external advisers. It is going to be extremely difficult for advisers to work out people's entitlements if they are to take a certain job or there is a change of circumstances coming and it is highly unlikely that the current range of 'better off' calculators will be able to deal with surplus earnings calculations.

4.9.4 We are currently discussing the introduction of Tax Free Childcare (TFC) with HMRC and there has been much discussion about the need for a calculator that tells people whether they should claim childcare support through TFC or UC. This is another complexity in that calculation, and one that most claimants and many advisers will be unable to understand as the information needed to work out figures accurately is unlikely to be available. All of this must be done with the claimant before they commit to taking on a job so they are fully aware of how it will affect them.

4.10 ***RTI data and reporting requirements***

4.10.1 The EM states that claimants whose awards terminate can opt to allow DWP to continue to collect RTI information. Those who do not choose to do that or those who have employers who do not operate RTI will need to report their earnings for the intervening period in order for any surplus to be calculated. This is going to add complexity and possibly a time delay while claimants gather the relevant information.

4.11 ***Calculation of surplus earnings – The impact of circumstances***

4.11.1 One major concern we have about the calculation of the surplus earnings is how the 'nil UC threshold' is calculated. As we outlined above, surplus earnings can be created by changes in circumstances as well as changes in income. In order to calculate the amount of surplus earnings to take into account, the income data for the intervening months (the months between the last period of the terminated claim and the first month of the new claim) is gathered in order to calculate the surplus earnings for each intervening month.

4.11.2 However, page 6 of the EM states that in relation to calculating the nil UC threshold in those intervening months 'the department may make assumptions about the claimant's circumstances over the period while they were not receiving UC'. It goes on to say 'In most cases the threshold will continue to be based on the circumstances when the previous award ended. This is to avoid complexity and the need to gather large amounts of evidence in relation to the period when UC was not being awarded'.

4.11.3 We think this decision is incredibly unfair for claimants. If DWP have made a decision to introduce a complex policy to take into account surplus earnings, they should not be able to choose only to take into account factors that are easy for them to determine when this may be to the detriment of the claimant.

4.11.4 Surplus earnings only exist where income is above the nil UC threshold. The nil UC threshold is set based on circumstances, therefore we cannot see how it is equitable for the DWP to set the nil UC threshold based on previous circumstances but intervening income.

4.11.5 For example, take a couple who have their UC claim terminated because one member of the couple takes up some overtime that is offered during a busy period at work. The following month they have the first child. Due to the extra expense and items needed for the baby, the working partner takes on even more hours. Once the overtime finishes after four months they come back on to UC. Based on DWP's current thinking, RTI data will be sent showing the increase in earnings due to the extra overtime after the child's birth and this will make their surplus income higher, however the fact that they have a child which would also raise their nil UC threshold is ignored. This means their surplus earnings will be higher than they should be if DWP had done a proper calculation.

4.11.6 The regulations themselves seem to be worded in such a way as not to specify what circumstances should be used when calculating the nil UC threshold in the intervening months. The only fair way to do this is to ensure the regulations are clear that both income and circumstances in the intervening period will be taken into account. Whilst this may be an administrative burden for DWP, it is inequitable for one to be considered but not the other.

4.12 ***Calculation of surplus earnings – six month period***

4.12.1 We have some concerns about the drafting of proposed Regulation 64A in relation to surplus earnings. In the EM Example 1 (Paul and Barry), DWP state that the process of reducing UC entitlement by surplus earnings 'continues until the surplus earnings run out or six months has passed'. However, it seems to us that the passage of six months may not end the impact of surplus earnings.

4.12.2 This is because Regulation 64A states that it applies where:

- The claimant was entitled to an award of UC that terminated within six months ending on the 1st day in respect of which the claim is made; and
- There were surplus earnings in the assessment period in which the old award terminated.

4.12.3 It appears to us that DWP assume that people with fluctuating incomes will not claim in the intervening periods but they will instead calculate their 'notional' surplus earnings when they do claim if it is within six months. However this will not be practical for most people because they will not have any idea when their surplus earnings might be used up and when their entitlement might start again so the best advice for them might be to claim each month. Also, it may be beneficial to actually claim so their 'real' UC income threshold is calculated if there is a change of circumstance so that any surplus earnings are eroded quicker. It appears no thought has been given to how this will be communicated to claimants and whether people with fluctuating incomes should claim.

4.12.4 Taking Paul from Example 1 of the EM, if Paul was to make a claim in assessment period 1 (following his assessment period with his large income) page 13 confirms that 'the £4,501 surplus earnings from his bank will be applied reducing his UC amount to £0 so there is no entitlement'. But if surplus earnings are treated as 'actual' earnings (as the EM states), it seems to us that this period would fulfil the requirements in Reg 64A and so another six month period would start.

4.12.5 If this is correct, it would mean that where there are high surplus earnings, or someone has a low UC threshold with high surplus earnings, they will not necessarily be extinguished at six months. We cannot believe this is the intended consequence and further clarification from DWP should be sought.

5 Self-employed – surplus earnings and losses

5.1 *Rationale for the policy*

5.1.1 Unlike the proposal for the surplus earnings policy, we do understand the need for changes for the self-employed. Over the last few years, we have made many representations on UC and the self-employed and have highlighted that one of the biggest problem areas of UC was the fact that it does not recognise fluctuating income and expenses that are a reality for many self-employed people nor does it have any provision for loss relief.

5.1.2 We welcome the fact that DWP recognise that the current legislation does not work well for the self-employed. However, as with the surplus earnings proposals we have a number of concerns about the proposed solution namely:

- It is incredibly complex.
- It potentially creates additional reporting requirements (over and above the already burdensome requirements).
- The interaction with the MIF means that in reality those with fluctuating incomes may still be adversely affected.
- The lack of recognition of pension contributions leading to disparity with employed colleagues.
- The surplus earnings policy means that a self-employed person can be worse off than an employed person even though they will earn the same amount over a 12-month period.

All of the points made above in relation to surplus earnings for the employed also apply to the self-employed.

5.1.3 Before commenting in detail on the proposed regulations, we would like to state that these comments should be read in conjunction with paragraph 5.4 below with regards to the MIF. We do not believe there is any justification for the current MIF and it does not sit well alongside these new proposals – for example the department recognises that businesses should be given loss relief but this is then reversed by application of the MIF.

5.2 *Disparity between the employed and self-employed*

5.2.1 We understand why the EM states that there is a need to recognise surplus earnings for the self-employed if relief is going to be given for losses. However, we do not think that the proposed surplus earnings policy is the right way to do this and we suggest alternatives below which we think are not only simpler but also fairer in practice for the self-employed.

5.2.2 We have previously raised concerns about the existing UC legislation in relation to the self-employed with Lord Freud and the disparity that it can cause between two people earning the same over a 12-month period where one happens to be employed and the other self-employed. Lord Freud gave an assurance during oral evidence at a Work and Pensions

Committee hearing[1] in September 2012 that ‘we are going to make sure that there is parity between the self-employed and employed’ and that ‘to the extent that there is not, we will sort that out’. It is therefore disappointing that no consideration or analysis has done on the impact of the surplus earnings policy between the two groups.

5.2.3 Had this analysis been done, it would reveal that:

- If Barry and Paul from Example 1 in the EM had been self-employed rather than employed, Paul would gain only £33 over 12 months from his irregular earnings compared to Barry’s regular earnings. This is in contrast to the £5,259 that employed Paul gained over employed Barry. This is because the MIF already in part deals with the ‘surplus’ earnings. So whilst the example in the EM might, in DWP’s view, support the introduction of surplus earnings for the employed, it does not support it for the self-employed.
- If the same example involved an employed person (Barry) and a self-employed person (Paul) (or indeed two self-employed people) the results when the proposed policy is applied are alarming. The Example highlights at the start that ‘Barry and Paul have the same nil point under UC and earn the same amount’. One would expect, whether they are employed or self-employed, that people on UC with the same circumstances and same earnings should get the same amount of money. However, doing the example again with Paul as self-employed shows as above that in the existing system Paul is only £33 better off over 12 months. Applying the surplus earnings policy makes Paul lose nearly £1000 of UC entitlement – so that Barry ends up with £1580 of UC over the 12 months and Paul with only £645. This is despite them both earning the same amount.

5.2.4 This disparity will exist because there will be cases of fluctuating income amongst the self-employed where there are no losses so they gain nothing from the other side of the new policy but instead are significantly worse off. In part this is because the MIF already acts in a way that it attributes earnings that are not actually there and so stops people with spikes (like Paul in Example 1) from gaining as much as employed person with such spikes would. To implement surplus earnings on top of the MIF means that self-employed people see a further decrease in their UC entitlement, far below that of their employed counterparts with the same earnings.

5.2.5 Given the commitment by Lord Freud that there should be parity between the employed and self-employed, this issue needs urgent attention. We have suggested in Paragraphs 6.1.5 and 6.2.3 that averaging earnings is a far fairer way to deal with situations like this. However, if averaging is not adopted and if our main recommendation for an anti-abuse provision in

---

[1] Q.288 – http://www.publications.parliament.uk/pa/cm201213/cmselect/cmworpen/576/120917.htm

Para 6.1.3 is not adopted, then the Regulations need to be re-written to remove this unfairness in some other way.

5.2.6 We are happy to make our workings available for inspection by SSAC or the DWP.

5.3 ***Other policy points***

5.3.1 We welcome the DWP's introduction of a cross-subsidy that allows profits or losses from each separate trade and profession to be combined to give an overall loss or profit from which any tax or National Insurance payments are deducted. However we are disappointed that this has not been extended to cross-subsidy between self-employed and employed earnings and earnings of joint claimants. Our proposals in Section 6 seek to address these issues as well.

5.3.2 We are once again disappointed at the DWP's approach to pension contributions in relation to the self-employed. Employed people under UC are allowed to deduct 100% of their pension contributions and their UC is based on this net amount. In effect this means that they could pay half of their salary into a pension scheme and UC could make up some of this difference. Yet, for the self-employed, not only does the MIF fail to take account of pension contributions (which can mean an employed person earning the same amount as a self-employed person can get more UC), these new proposals do not allow losses to include pension contributions so that if a self-employed person has a month where they have a large expense, they may get no recognition for their pension contributions. This too sets the self-employed at a material disadvantage from the employed claimant in otherwise similar circumstances.

5.3.3 Despite the EM containing eight examples, only one of those shows the self-employed policy for losses/surplus earnings in operation and even then it is a very simple example with a small loss in one assessment period. However in reality it will be the case that people will have surplus earnings in some months and losses in others and that will repeat up and down throughout the year. It would be helpful if DWP were to produce models of other situations where receipts and expense fluctuate more throughout the year as this is likely to show the complexity and show any unintended consequences such as those shown above in section 5.2.

5.4 ***Reporting requirements, record keeping and communications***

5.4.1 We mentioned in section 4.10 above that record keeping for those outside of the RTI system will be burdensome. This will be an even greater problem for the self-employed who will need to keep monthly figures even if they are not claiming UC. This is a further burden on the self-employed as when they 'reclaim' UC they will need to produce figures for the intervening period. There will also be additional complexity for self-employed businesses who are unable to use the cash basis for their tax returns, such as businesses claiming the herd basis, as the accounts they prepare under the accruals basis for tax purposes could be very different from the monthly UC cash accounting required.

5.4.2 The EM does not touch upon the detail of how this policy will work in practice for the self-employed. Who will keep track of the losses? Will it be the responsibility of the self-employed person when filling in their monthly form to indicate if they have losses they want to relieve? Or will the system work out the losses and carry them forward deducting them at the appropriate time? This is likely to take some time and could delay a claim when support is needed urgently.

5.4.3 We also noted above in section 4.9 the challenges around communication of such complicated rules. For the self-employed, trying to design an award notice that not only deals with the surplus earnings and losses but also then shows the interaction with the MIF will be an extremely difficult task.

5.4.4 We are very concerned that as only a handful of self-employed have come through the UC system so far and few are expected before this policy rolls out in 2016 that there will not be sufficient testing of materials, guidance and award notices.

5.5 ***Interaction with the Minimum Income Floor (MIF)***

5.5.1 Since the MIF was first mooted in relation to the self-employed in UC we have been firmly against its introduction. In a recent report[1] DWP stated that:

> 'Universal Credit has also developed new policies and procedures to protect the taxpayer from those who declare themselves self-employed, yet whose businesses routinely generate little income. In the legacy systems, they would receive tax credits to make good the repeated absence of income, with no obligation to increase their earnings. Universal Credit has addressed this by creating a test of "gainful self-employment". This seeks to clarify whether the self-employment is organised, developed and carried out in expectation of profit. Those who do not pass this test are subject to greater conditionality to find more work, in return for their Universal Credit.'

5.5.2 What this paragraph fails to note is that the self-employed person who does pass the 'gainful self-employment' test because they are carrying on their business in an organised, developed way and in expectation of profit is subject to the MIF. For those who have fluctuating incomes, such as farmers and entertainers, whereby their income comes in some months of the year with others having little or no income but large expenses, they are treated as earning the MIF.

5.5.3 In terms of the proposed regulations, any losses that are being carried forward are used up and then the MIF is applied. This means that if someone has two months of large expenses which creates a loss in those months then in the third month has a profit they can reduce that profit by those losses. However if the profit is reduced below the MIF level, they are

[1] https://www.gov.uk/government/publications/universal-credit-at-work

then brought back up to the MIF level, which effectively means they are not getting loss relief in full.

6 LITRG proposals

6.1 *Surplus earnings*

6.1.1 For the many reasons set out above, we do not think that the surplus earnings policy should be introduced as drafted. As well as being extremely complex for claimants and difficult to administer and explain for the DWP, it impacts most on those who are not seeking to manipulate the system and still leaves open the opportunity for those who wish to maximise UC by spreading income out over a longer period.

6.1.2 We have two proposals that address the two main DWP concerns – manipulation of income and fluctuating incomes.

Proposal 1 – Manipulation of income

6.1.3 The first proposal to tackle those who seek to manipulate the system is to introduce a general anti-abuse provision that allows DWP to average a person's earnings over a reasonable period that reflects their working pattern where they are attempting to change their earning patterns to increase their UC.

6.1.4 We think this will be fairly straightforward in practice and easy to identify for the system where there are odd income patterns. Given that DWP will have to average these people's earnings anyway for conditionality purposes, it makes sense that the same figure is used for the income calculation.

Proposal 2 – Fluctuating incomes

6.1.5 The second proposal, to deal with the issue for those on fluctuating incomes, is to use a system of averaging. The regulations are already in place for averaging in relation to determining whether someone with fluctuating income meets the conditionality threshold. If DWP are doing this calculation anyway, it makes perfect sense to use the same figure for earnings. This will mean those with fluctuating incomes will have certainty and DWP will only have to deal with one figure. It will also be easier for people to understand as it is used in the current DWP benefits system (housing benefit, for example).

6.1.6 These proposals not only target the two groups that DWP are concerned about but also reduce complexity and mirror existing regulations in relation to averaging for conditionality purposes.

6.2 *Self-employed*

6.2.1 Our first proposal in relation to the self-employed is to remove the MIF for those people who are gainfully self-employed. If someone is carrying out business activity in an organised, developed manner and in expectation of profit, they should not be penalised with the MIF.

Only those who do not pass the gainful self-employment test should have the MIF imposed if they do not wish to accept the conditionality requirements.

6.2.2 If the MIF is retained, we propose that DWP amend the regulations to allow pension contributions to be deducted when calculating the MIF. Otherwise this leaves the self-employed in a worse position than their employed counterpart earning a similar amount.

6.2.3 In relation to dealing with surplus income and losses for the self-employed, we would propose that consideration is given to a system of averaging. Again, this is currently used in existing benefits, would be easier to understand for claimants and easier for DWP to administer than a complex system of losses and surplus income.

LITRG
10 November 2014