



TAXREP 60/14 (ICAEW REPRESENTATION 150/14)

THE UNIVERSAL CREDIT (SURPLUSES AND SELF-EMPLOYED) REGULATIONS 2014

Response submitted on 10 November 2014 by ICAEW to the consultation, published by The Social Security Advisory Committee (SSAC) on 17 October 2014, on the [government's intention to take account of surplus earnings and to allow restricted relief for self-employed losses in the universal credit system.](#)

This response was prepared on behalf of ICAEW by the Tax Faculty

Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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UNIVERSAL CREDIT – PROPOSAL TO TAKE ACCOUNT OF PAST EARNINGS IN REPEAT CLAIMS AND TO ALLOW RELIEF FOR SURPLUS LOSSES

KEY POINTS

1. The Universal Credit (Surpluses and Self-Employed Losses) Regulations 2014 (the Regulations) do two things: one is to introduce a mechanism to adjust for ‘surplus earnings’ and the other is to provide some relief for losses suffered by self-employed earners.
2. We welcome DWP’s recognition of the need for the Universal Credit (UC) rules to give relief for the excess of payments over receipts suffered by self-employed businesses, by allowing set off of net receipts in future periods. For many small businesses, cash must be spent in order to generate future receipts, so this seems fair. Unfortunately, the impact of the minimum income floor (MIF) will mean that much of the benefit of this spreading is lost.
3. We do not agree with the proposals to limit a future claim to UC by reference to surplus earnings made in the previous six periods during which the household was not claiming. This is intended to tackle abuse of the system by manipulation of income, but no evidence is presented to show that such manipulation is likely to be a real problem. It therefore seems disproportionate to make such a fundamental change to the operation of UC, affecting all claimants. It is also unfair as there is no regard to changes in circumstances that would have affected a notional claim during these periods. We think that a general anti-abuse provision would be a better way to tackle the perceived problem.
4. The concepts of surplus earnings and surplus self-employed losses are both complicated, and even more so when they interact. We have ourselves struggled to follow the examples in the Explanatory Memorandum, though we have been working on UC for some time. We are extremely sceptical that claimants will find it easy to understand the rules, or DWP advisers to explain them. This removes the benefits which UC offers of simplicity and predictability, and could be a disincentive to those seeking to take on new work.
5. We are very disappointed that DWP has not taken the opportunity to undertake any consultation on these far-reaching proposals, apart from presenting them to the SSAC.
6. In conclusion, although we welcome the recognition of the problem of self-employed losses, we do not support the introduction of these regulations as drafted.

GENERAL COMMENTS

7. We consider that the problem of giving relief for unrelieved losses is one of fairness. The concern about claimants manipulating earnings by colluding with employers to effectively receive their annual income just once or twice a year, is different and is about claimants abusing the system.
8. The Universal Credit (surpluses and self-employed) regulations 2014 are welcome in that they recognise the need for the Universal Credit rules to give relief for the excess of payments over receipts by allowing set off of net receipts in future periods. For many small businesses, cash must be spent in order to generate future receipts, so this seems fair. Unfortunately, it appears that the impact of the minimum income floor (MIF) will mean that much of the benefit of this spreading is lost.
9. We do not agree with the proposals to limit a future claim to UC by reference to surplus profits made in the previous 6 periods during which the household was not claiming. This is particularly unfair as there is no regard to changes in circumstances that would have affected a notional claim during these periods.
10. These two issues are different and require separate approaches.

11. The rules applied to partnerships will be impossible for claimants to understand. They will not be able to use them and this needs urgent attention.
12. We recommend a new approach is needed for UC claimants who have business income. The most obvious solution would be to use an estimate taken from the cash based results from the previous period's income tax assessment, similar to that used for tax credits. While we accept this will not give an exact picture of current need, this seems the only pragmatic solution.

SPECIFIC COMMENTS

Surplus earnings and income manipulation

13. It is easy to imagine how in an academic sense an employee could collude with their employer so that they were only paid once or twice each year. This would indeed mean the employee's claim to UC would stop in the months when they were paid and would then be significant in the other months of the year.
14. The reality is that we have not seen any evidence that this has happened. In theory, this technique could be used to save National Insurance too, but we are not aware that it has been. People on very low income need to budget very carefully, which is why historically they find it easier to manage when paid weekly. Being paid only once or twice each year would be unmanageable.
15. Self-employed people are even less likely to bunch their receipts in the way suggested. Many are beset by cash flow problems and would be most unlikely to do anything other than greet payments with enthusiasm, whenever they arrive, the earlier the better.
16. These rules are particularly unfair as there is no regard to changes in circumstances that would have affected a notional claim during these periods.
17. Those claimants who have sufficient income to be able to manipulate their income to abuse the UC system, could easily defer income beyond the 6 month cut off point.
18. Rather than the extremely complicated and administratively burdensome suggestion in these draft regulations, we suggest a general anti abuse rule would suffice.

Surplus losses

19. We welcome consideration of giving relief for surplus losses. Unfortunately, the method being proposed is unfair, due largely to the impact of the MIF. It is helpful to state that the term 'surplus losses' is misleading. What the rules are actually doing is seeking to give relief for an excess of payments over cash receipts in a monthly assessment period. The relief is therefore just smoothing out the problem encountered by a business which is being prevented from properly matching its income with the expenditure related to earning it, as would happen if normal accruals accounting had been used. This is merely a function of cash flow and relief for this mismatch is appropriate.
20. When a business suffers a loss, the loss itself can be calculated for income tax purposes either using accruals accounting, or using the income tax cash basis. There are then different rules for allowing income tax loss relief, depending on which method for calculating the loss is used.

21. This same income tax loss is also available for Class 4 National Insurance relief purposes, although the rules of set off for NIC are different from the income tax rules.
22. When tax credits were introduced, the loss relief rules were criticised because they were different from both the income tax and the NIC rules. This was, and still is, complicated for claimants and their advisers and the system did not make it easy for households to keep track of these.
23. The proposals for UC are different yet again and are even more complicated because of the interaction with the Minimum Income Floor. It is unfair that losses can be used to take a claimants future income below the MIF for that period, since the result is that the loss is then wasted.
24. The particular groups who will be most adversely affected by the restrictions on the carrying forward losses rules, are seasonal businesses and those who undertake contract work where income is received infrequently or only at the end of a job, while expenditure must be incurred up front.
25. A business is either trading with a view to a profit/surplus, or it isn't. There are already plenty of rules to help determine this for other taxes and these could be used for UC purposes too. A single periodic review to determine the commerciality or otherwise of a business' trading status should be sufficient across all taxes and benefits. Once this was established, for example for a farmer, losses could be carried forward with the MIF being disregarded. A review could be conducted perhaps annually if it was considered necessary. It would soon be obvious whether the business was failing or not.

Pre trading expenditure

26. The rules for income tax allow pre trading expenditure in the seven years before trade begins, to be relieved as if incurred on the first day of trading. We consider that similar relief should be incorporated into the UC rules although accept that a shorter period might be considered more appropriate.

Post cessation expenditure

27. Post cessation expenditure, commonly on utility bills, rent or insurance, should be allowable in the assessment period in which they are paid for the 12 months following cessation of trade.

Pension contributions

28. The owner of a small business will often pay pension contributions annually rather than monthly. They will wait to calculate their taxable profits at their year end and then pay accordingly. It would seem fair for any loss to be created by the one off payment to be carried forward without regard to the MIF in future assessment periods. Alternatively, perhaps on making a single payment of perhaps £600 for the year, the claimant could be allowed to spread relief over the following 12 months so that the benefit is also spread.

Communicating the rules

29. These rules are non-intuitive and explaining them will be difficult. The interaction with the MIF will be particularly difficult.
30. Although the graphs showing above and below the line usage are useful, we very much doubt they will help the average claimant to understand the rules. That most of the explanation will be by advisers over the telephone will make this challenging to explain.

Record keeping

31. The record keeping requirements facing a small business owner who is claiming UC, are particularly challenging. It will be very difficult for them to continue to keep separate monthly records of receipts and payments after they stop claiming UC. Such entrepreneurs are notoriously optimistic and would not anticipate their results sliding back again within the next few months. If they did, they would understandably contemplate just giving up. Insisting on them keeping records after their claim has stopped, sends a very negative message.

IT and support software

32. No mention has been made of the costs of rewriting software to reflect these changes. We presume these would be significant.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see [icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx](https://www.icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx))