Self-employment and entrepreneurship: lessons from tax records and challenges for policy

Institute for Fiscal Studies
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Trends in profits of self employed sole traders: evidence from tax data

Jonathan Cribb
Real mean and median profits of self employed sole traders

Average self employed profit (£ per year, 2015-16 prices)

Tax year

Source: IFS calculations using HMRC Self Assessment Tax Records. Inflation adjusted for using CPI plus mortgage interest payments
Real mean and median profits of self employed sole traders

Mean: down 21% since 2007-08

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Change in distribution of profits

3.9% of self employed had profits between £0 and £500

Source: IFS calculations using HMRC Self Assessment Tax Records. Inflation adjusted for using CPI plus mortgage interest payments
Change in distribution of profits

Source: IFS calculations using HMRC Self Assessment Tax Records. Inflation adjusted for using CPI plus mortgage interest payments

Trends in profits of self employed sole traders: evidence from tax data
Change in distribution of profits

7.2% of self-employed had profits between over £40,000

Source: IFS calculations using HMRC Self Assessment Tax Records. Inflation adjusted for using CPI plus mortgage interest payments
Change in distribution of profits

4.7% had profits between £0 and £500

4.3% had profits of over £40,000

Source: IFS calculations using HMRC Self Assessment Tax Records. Inflation adjusted for using CPI plus mortgage interest payments
Change in distribution of profits

% of self employed with profits of £15,000 + fell from: 33% to 24%

Source: IFS calculations using HMRC Self Assessment Tax Records. Inflation adjusted for using CPI plus mortgage interest payments
What drove the fall in profits 2007-08 to 2011-12?

- Proportion of self-employed sole traders (RH axis)

- "Stayer" (self-employed in 2007-08)
- "Entrant" (joined since 2007-08)

Self-employed in 2011-12

Trends in profits of self-employed sole traders: evidence from tax data
What drove the fall in profits 2007-08 to 2011-12?

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What drove the fall in profits 2007-08 to 2011-12?

Low profits of “entrants” reduces average profits

<table>
<thead>
<tr>
<th>Mean profit (£ per year, 2015-16 prices)</th>
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16% (£2,500) fall in profits of “stayers”

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Trends in profits of self employed sole traders: evidence from tax data
What drove the fall in profits 2007-08 to 2011-12?

- **Low profits of “exiters”** increases average profits
- **Fall in profits of “stayers”** reduces average profits
- **Low profits of “entrants”** reduces average profits

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Self employed in 2007-08

Trends in profits of self employed sole traders: evidence from tax data
Decomposing changes in profits

Contribution to real mean profit growth

- Entrants
- Exiters
- Stayers
- Total

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Decomposing changes in profits

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Trends in profits of self-employed sole traders: evidence from tax data
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Contribution to real mean profit growth

Entrants Exiters Stayers Total

Trends in profits of self employed sole traders: evidence from tax data
Summary: Falling self employed profits in aftermath of the Great Recession

Average (mean) profits of self employed sole traders 21% lower in 2015-16 than 2007-08 after adjusting for inflation

- Mostly driven by 23% fall between 2007-08 and 2011-12; very modest recovery since
- Median profits down 7% since 2007-08

Key driver of the falls in average profits 2007-08 to 2011-12 was fall in profits of those who remained in business over the period (“stayers”)

- Their profits fell 16% over the period, in contrast to pre-recession years when profits of “stayers” rose
- Profits of new entrants relatively low, but this is always the case, so cannot explain large falls after 2007-08
Fewer high profit sole traders, more with very low profits

Proportions of self-employed sole traders with profits between £0 and £2,000 and profits over £40,000 from 1999-2000 to 2015-16.
Self employed sole traders with very low profits (£0 to £2000):

- Look very different on a range of measures to those with higher or lower profits
Characteristics of sole traders with very low profits in 2015-16

- % who have income from employment
- % in first year of self employment
- % who use capital allowance
- % in construction

- £0 to £2000 in profits
- Less than £0 profits
- More than £2000 in profits
Self employed sole traders with very low profits (£0 to £2000:

• Look very different on a range of measures to those with higher or lower profits

• Seem consistent with them undertaking self employment in a much less intense way

• Could this be consistent with a rise in “gig economy” workers or “kitchen table businesses”?
  • Low hours of work and little capital alongside other economic activity
Self employed sole traders with high profits

Self employed sole traders with high profits (£40,000+):

• Fallen from 8% of self employed to 4% of self employed since 2003-04

• Two thirds are in 4 industries: construction (22%), medical (17%), finance (14%) and business services (14%)

• Have higher turnover, employ more people, use more capital allowances, and have been in self employment for longer

• But, this has been changing in recent years...
Substantial falls in turnover for self employed with high profits

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Substantial falls in turnover for self employed with high profits

Median annual turnover for self employed sole traders with profits of at least £40,000

- Turnover fallen by 28% (£32,000) since 2003-04

Trends in profits of self employed sole traders: evidence from tax data
Changing characteristics of self employed sole traders with earnings of at least £40,000

- % with employee(s)
- % who use capital allowance
- % who have employment income
- % self employed for last four years

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Self employed sole traders with high profits (£40,000+):

- To what extent are high profit self employed incorporating to take advantage of the lower tax liabilities?

- Are there other compositional changes that are occurring?

- To what extent are these relatively high profit people becoming less productive?
Conclusions

Average (mean) profits of self employed sole traders 21% lower in 2015-16 than 2007-08 after adjusting for inflation

Key driver of the falls in average profits 2007-08 to 2011-12 was fall in profits of those who remained in business over the period (”stayers”)

Increased proportion of sole traders with very low levels of profits
- Often running a new business with little capital and alongside other employment

Decreased proportion of sole traders with profits over £40,000
- Large falls in turnover, investment in capital and employment
- While some may be incorporating, also see large falls in profits of high profit self employed who remain in business