

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

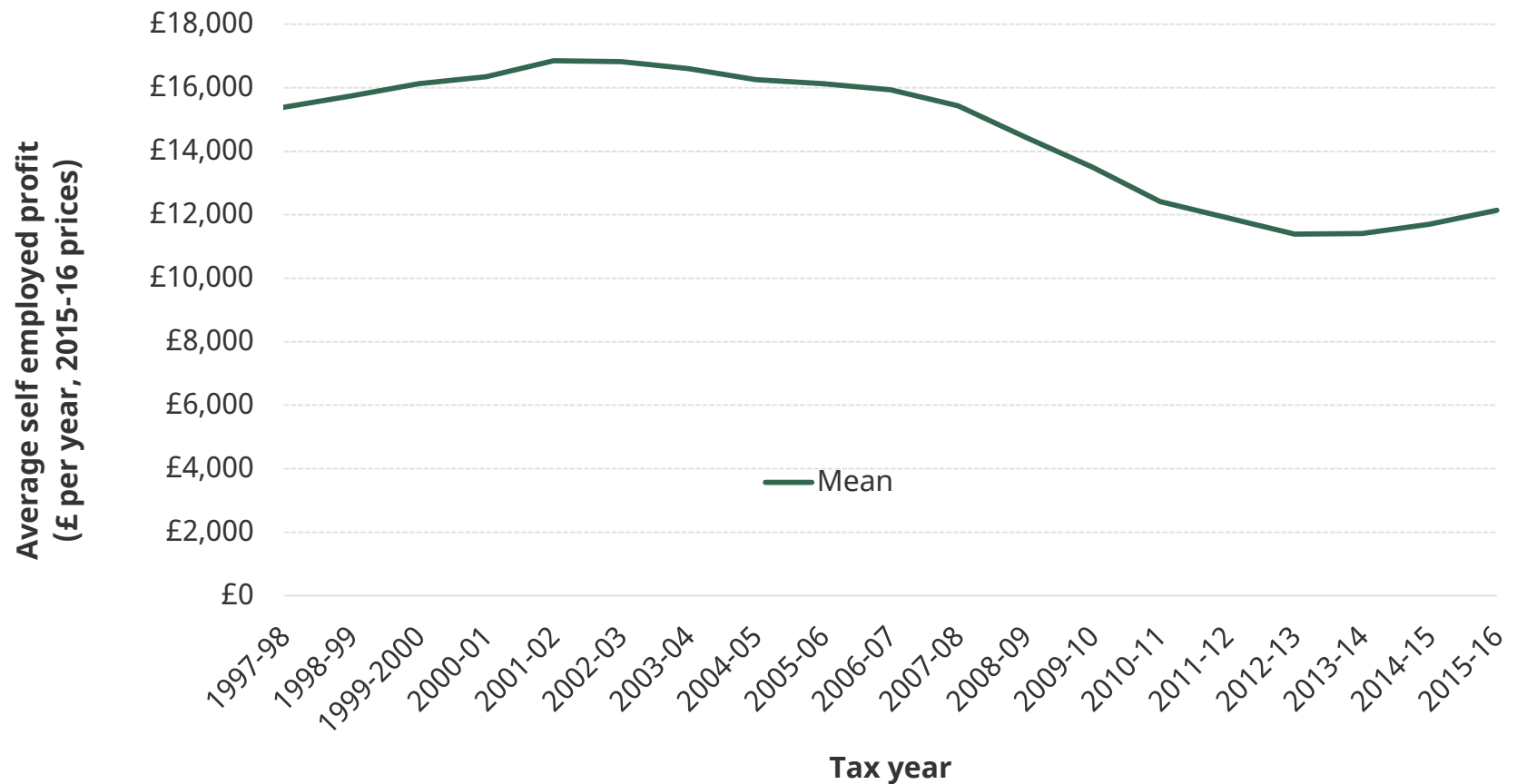
Institute for Fiscal Studies

4 June 2018

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

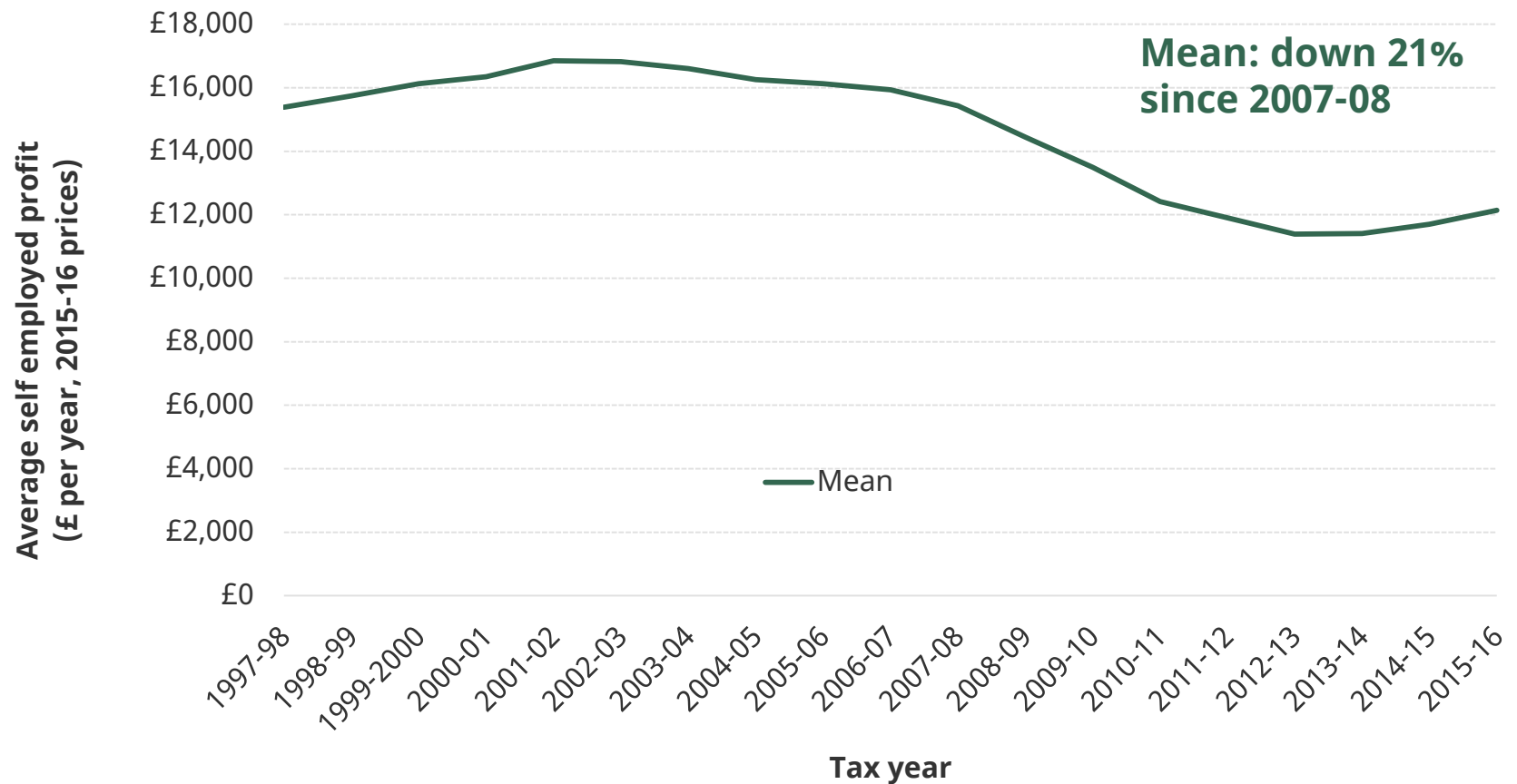
Jonathan Cribb

# Real mean and median profits of self employed sole traders



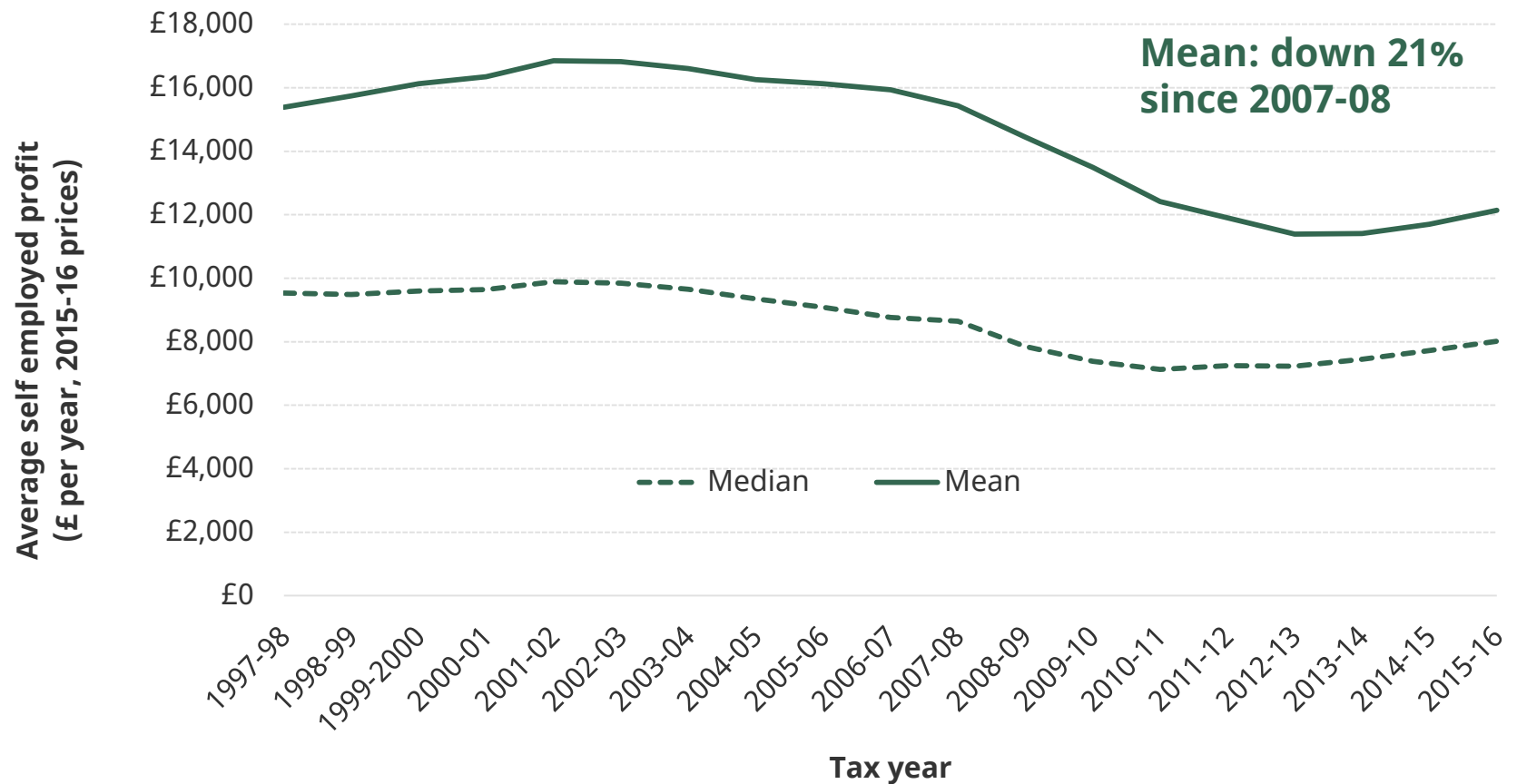
Source: IFS calculations using HMRC Self Assessment Tax Records. Inflation adjusted for using CPI plus mortgage interest payments

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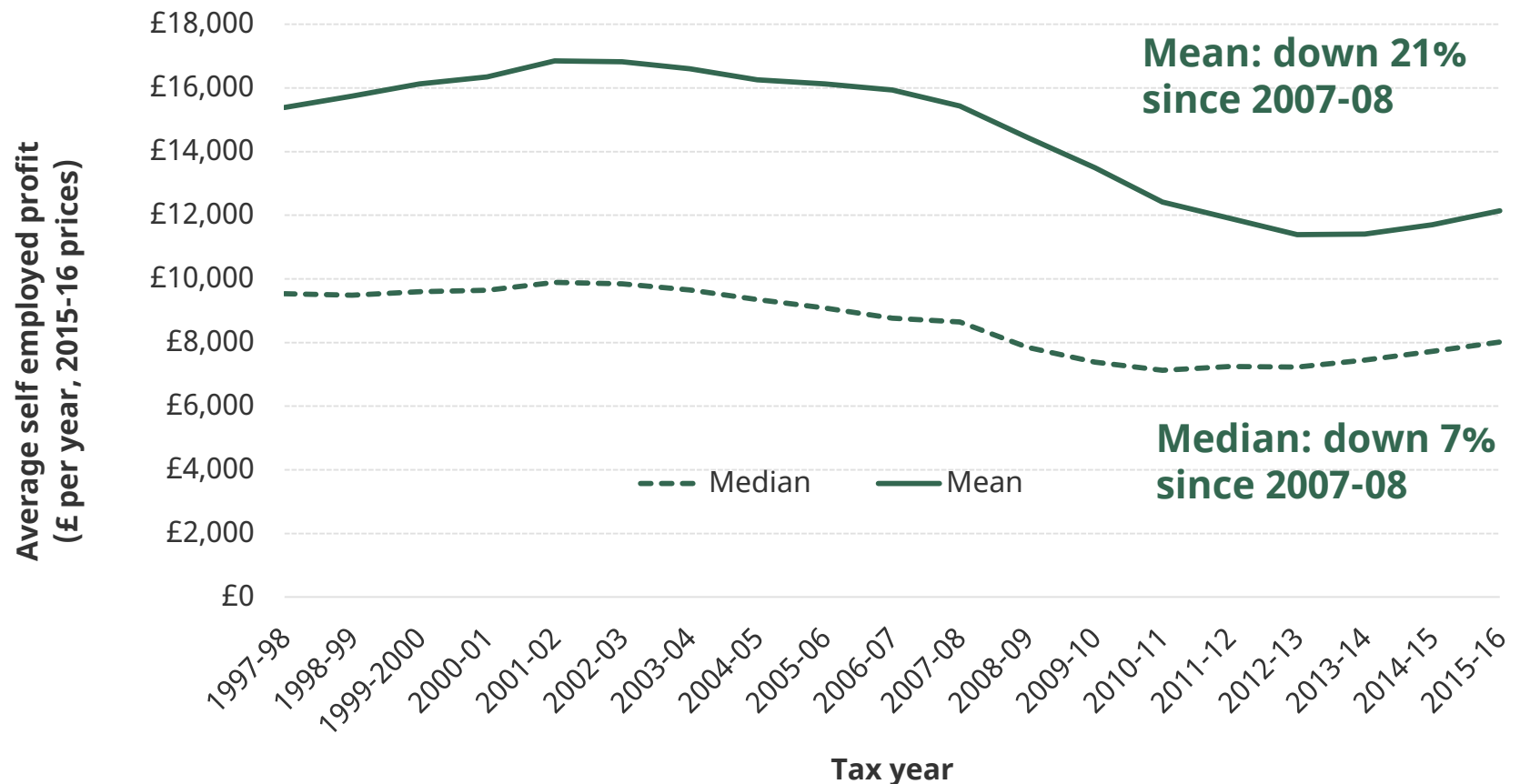
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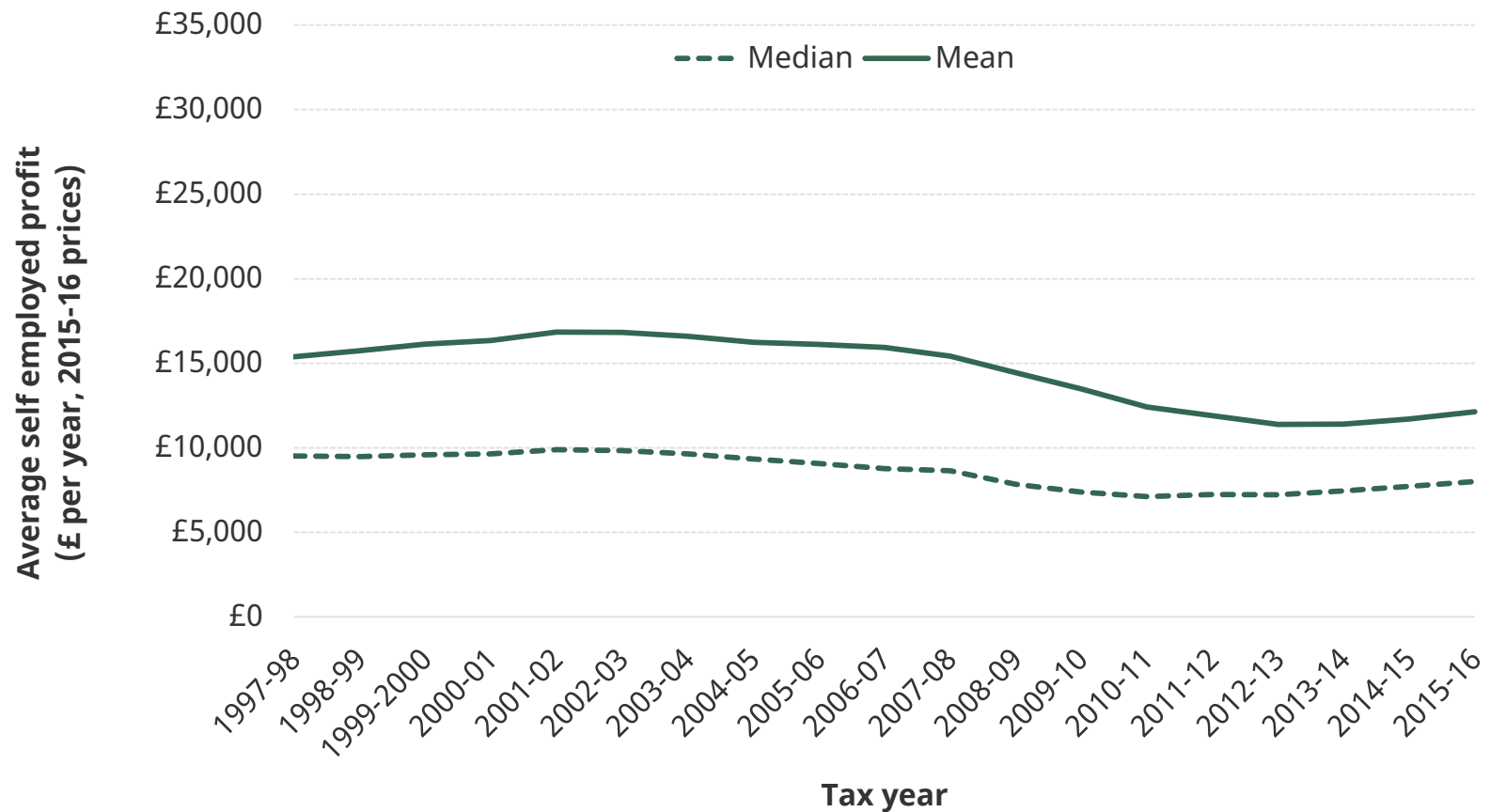
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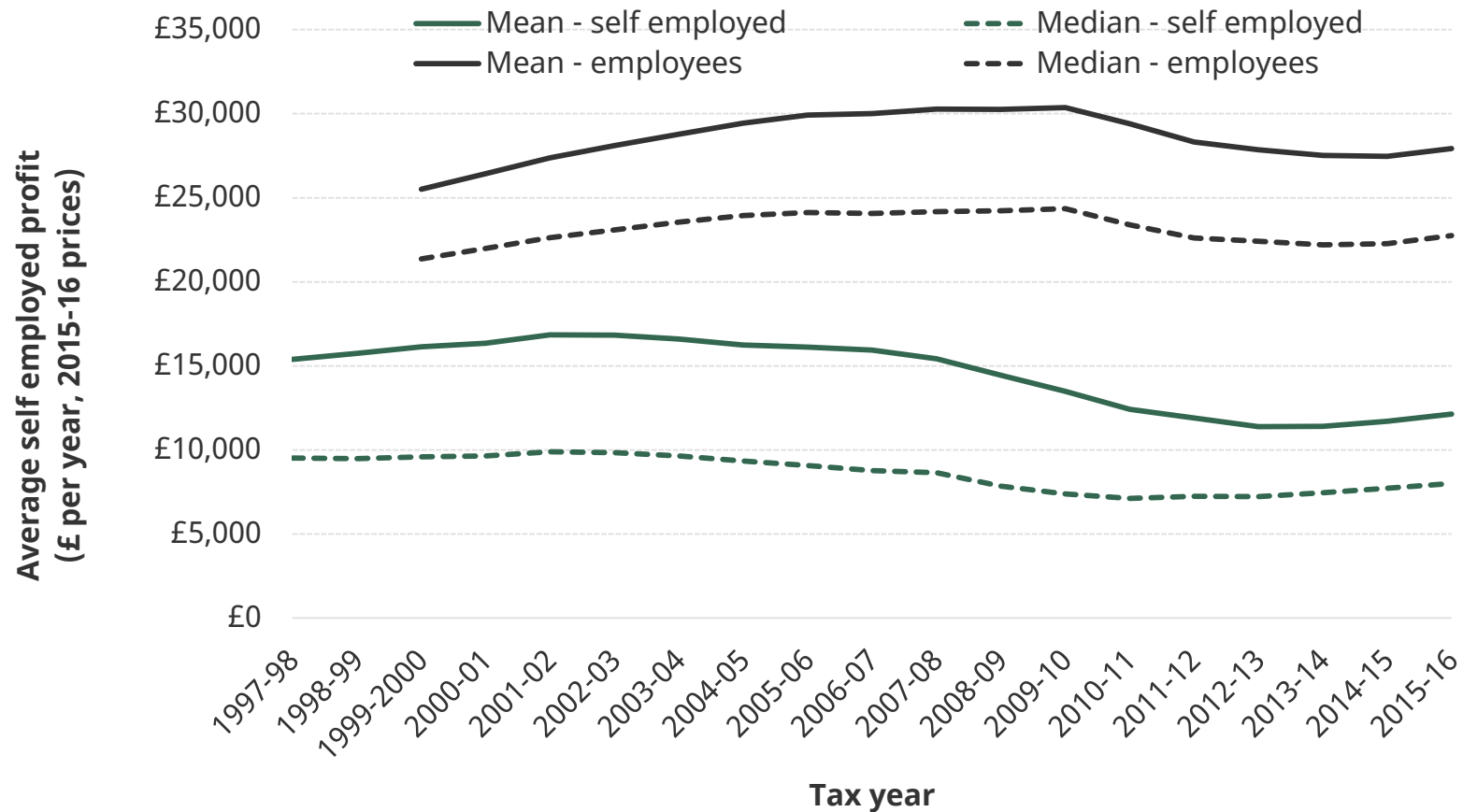
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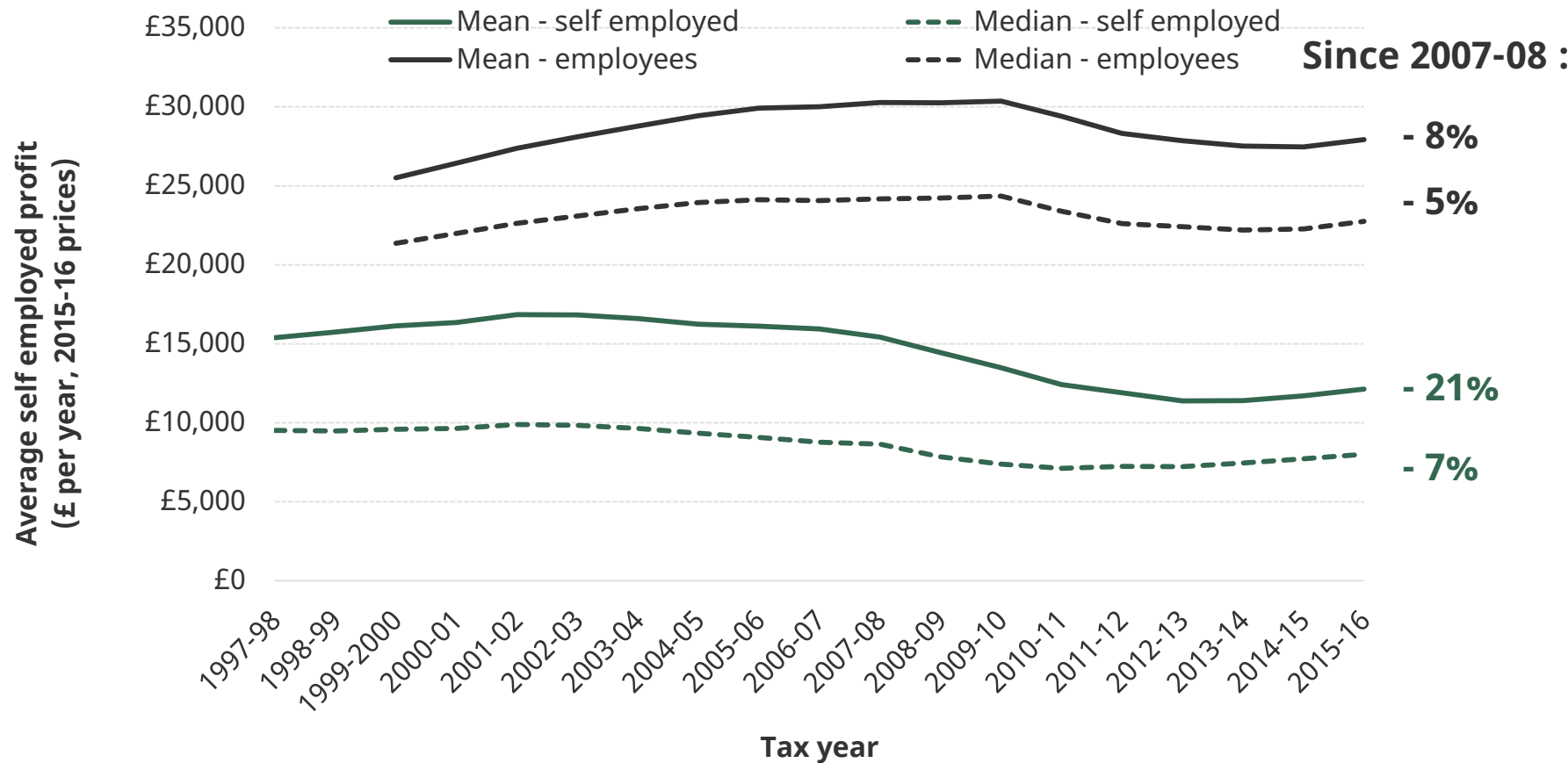
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Source: IFS calculations using HMRC Self Assessment Tax Records. Employee earnings from the Annual Survey of Hours and Earnings. Inflation adjusted for using CPI plus mortgage interest payments .

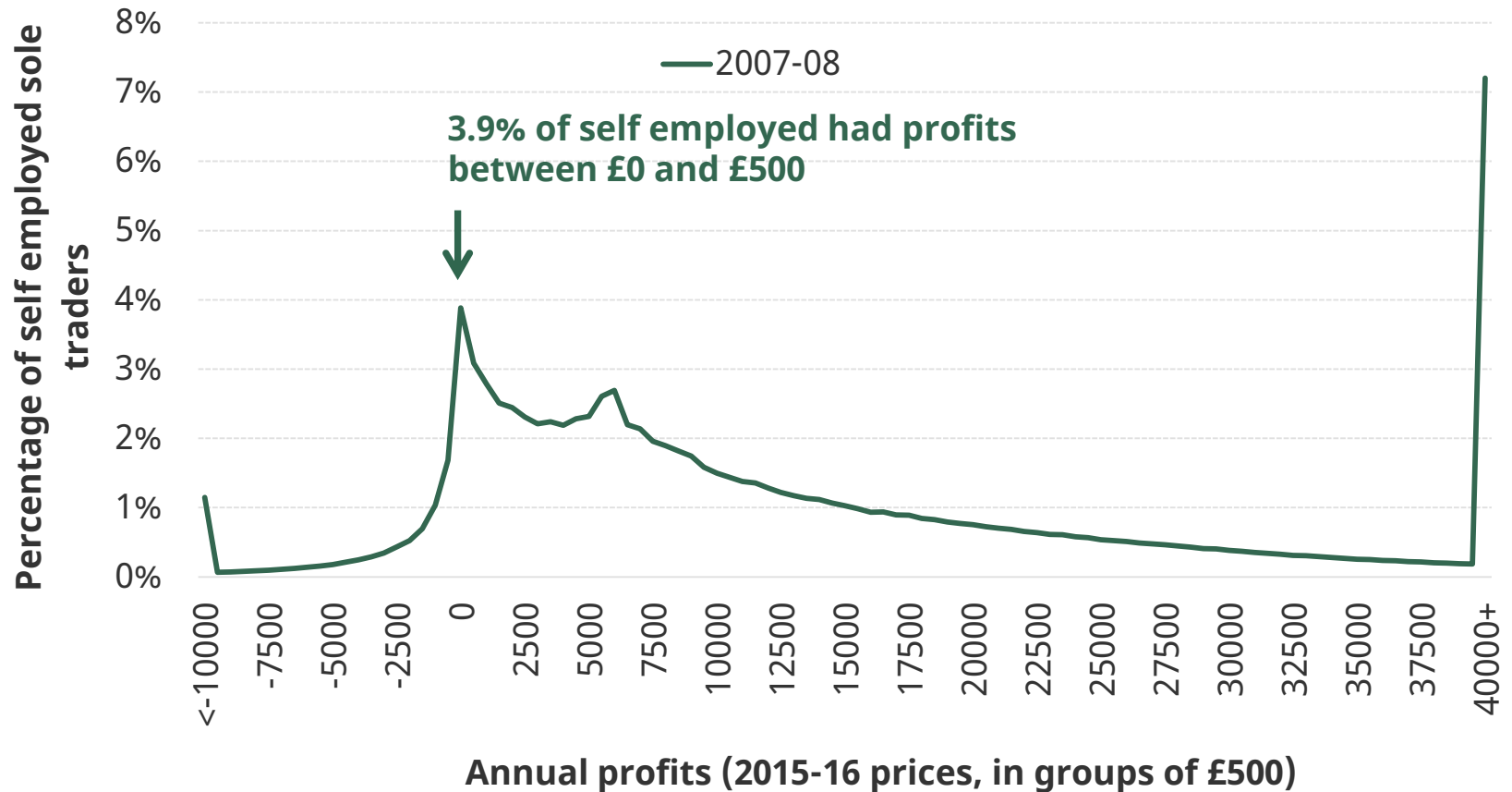


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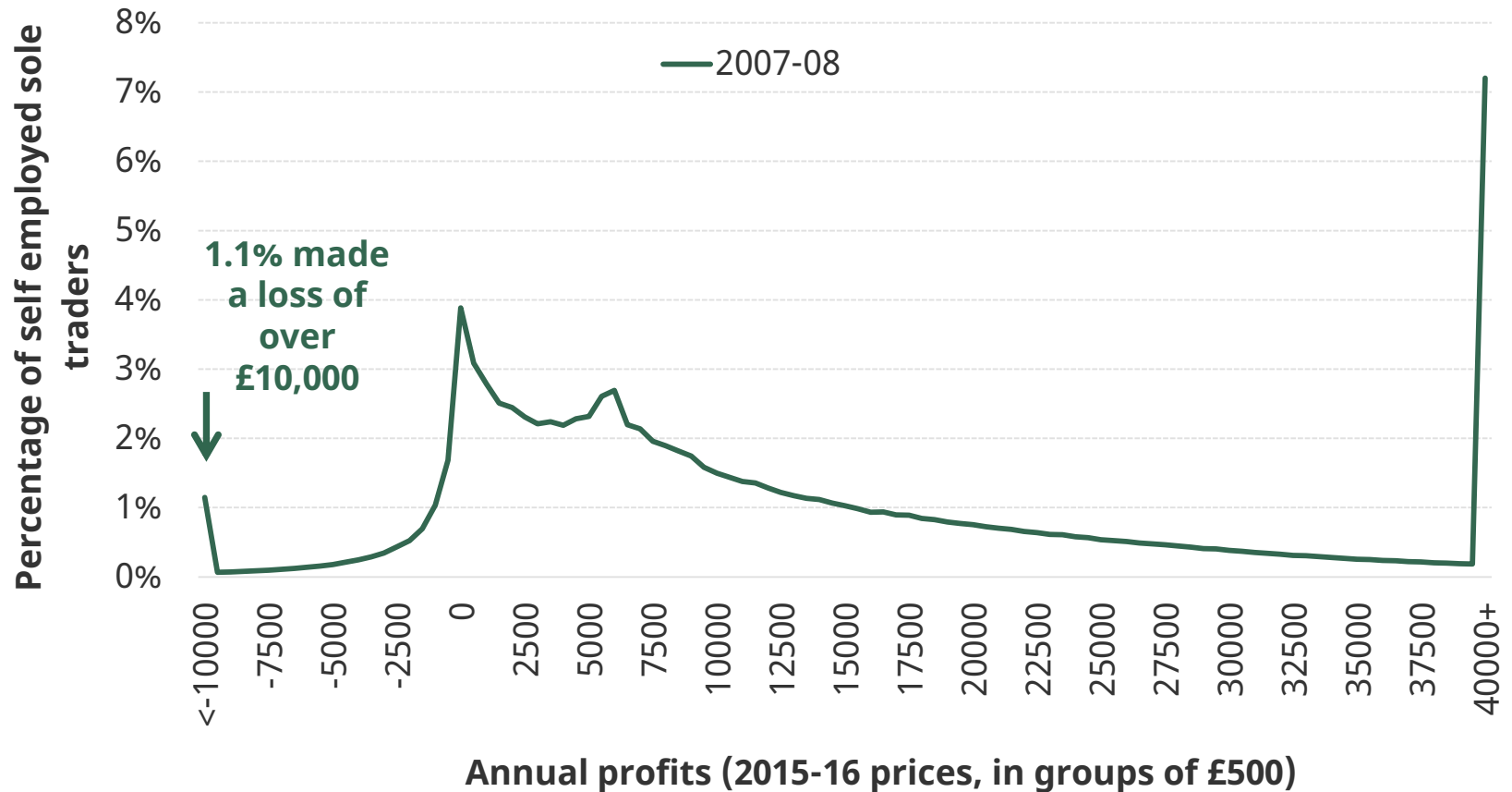
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# Change in distribution of profits



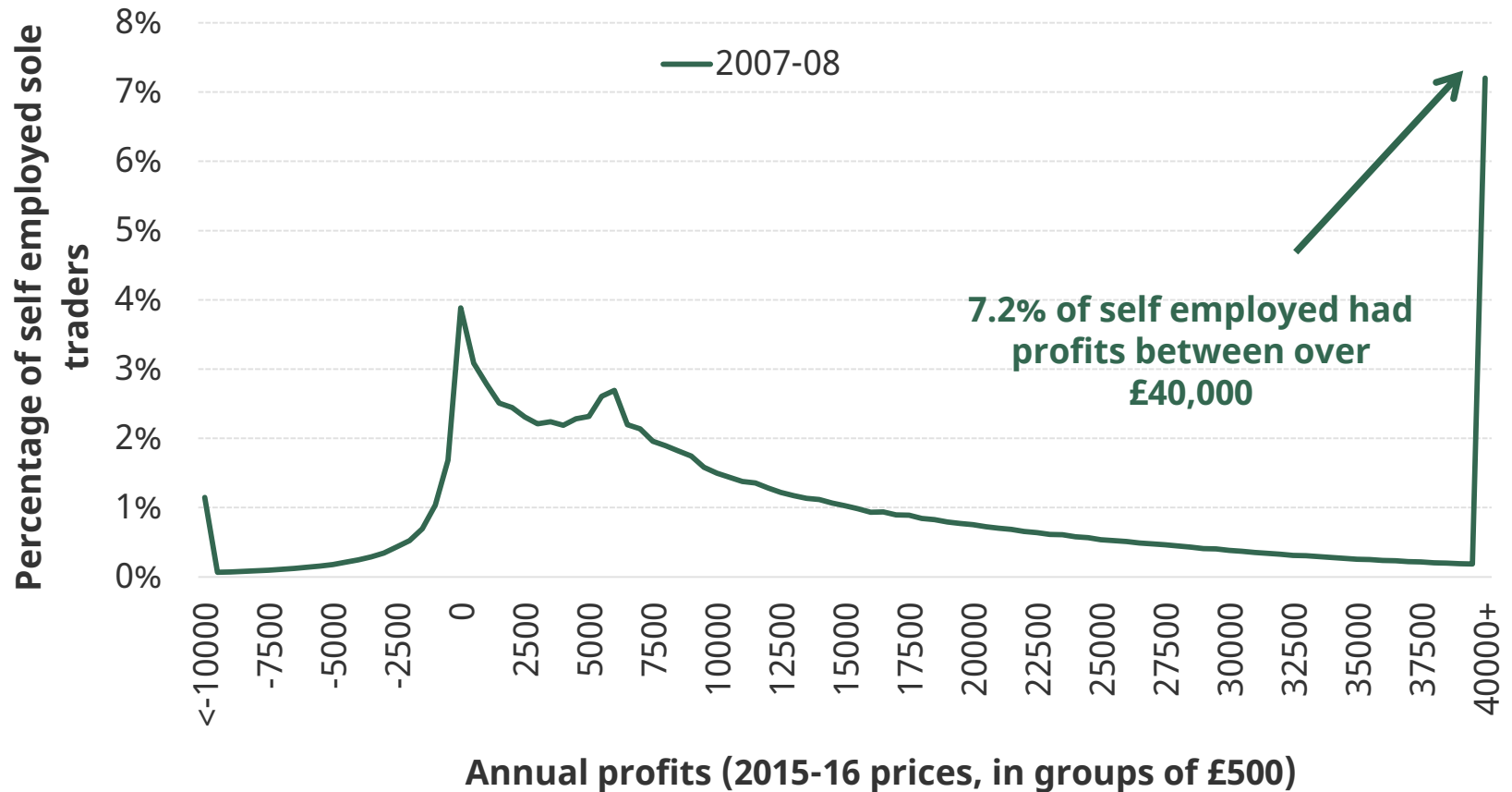
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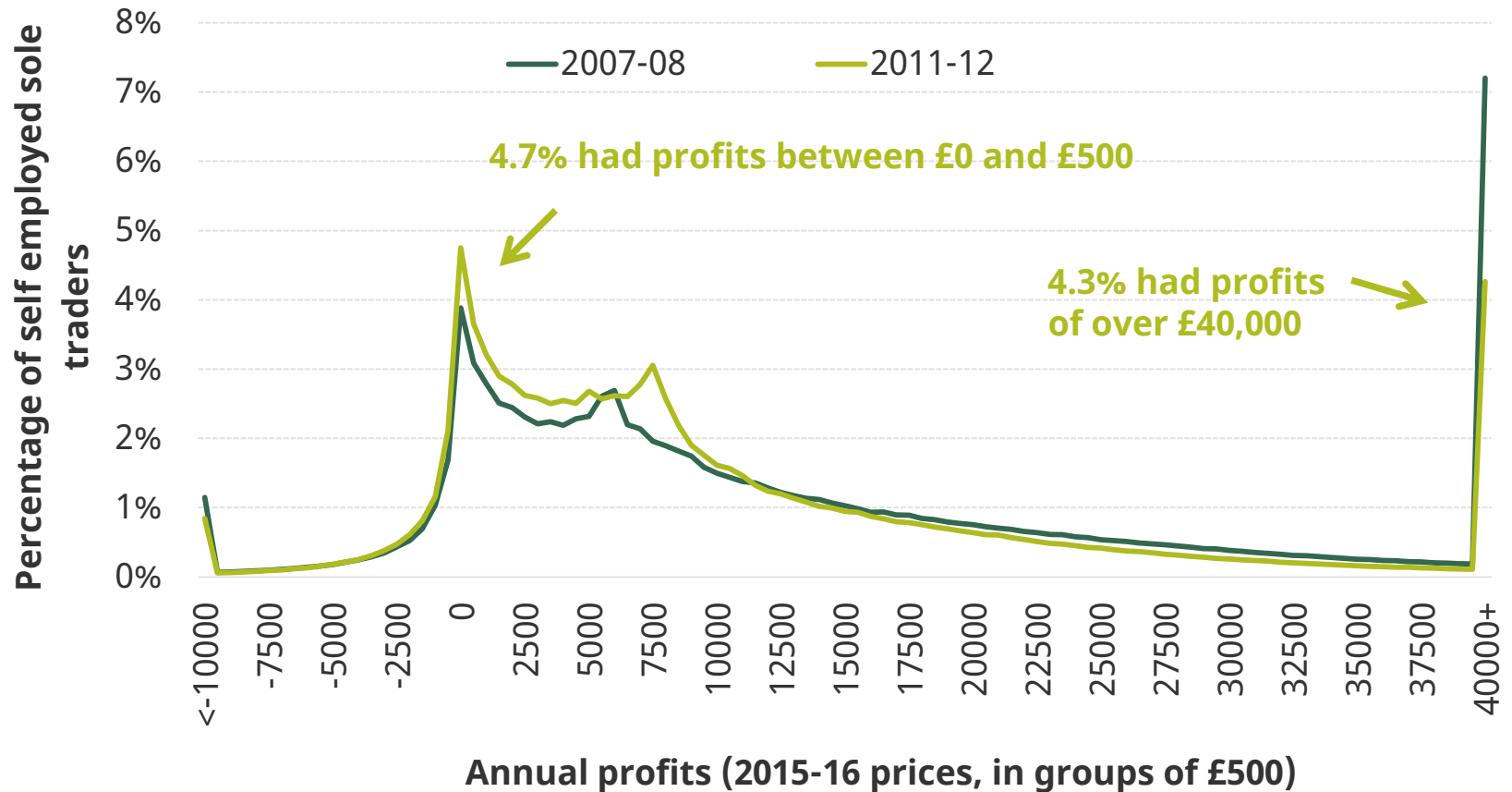
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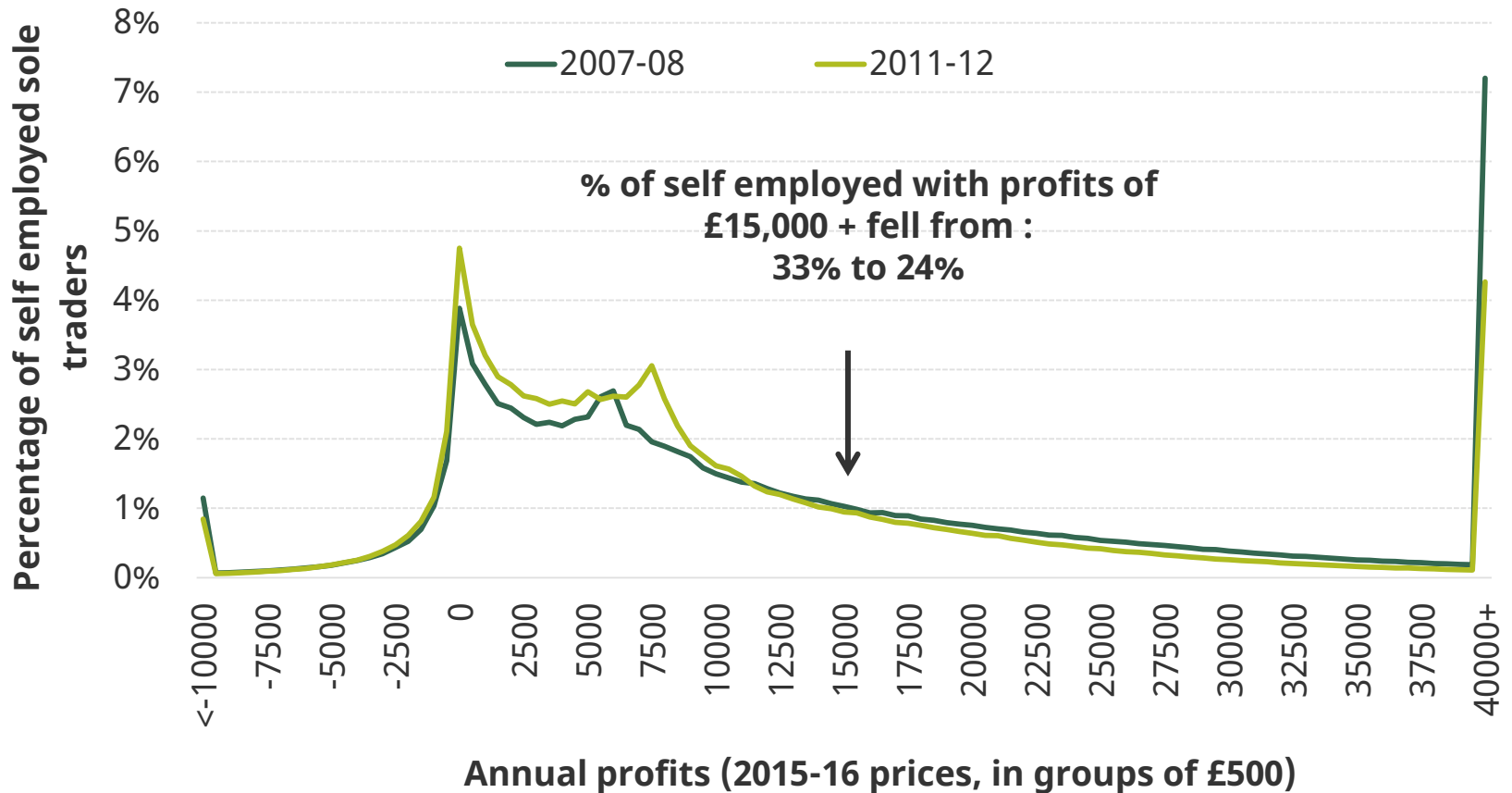
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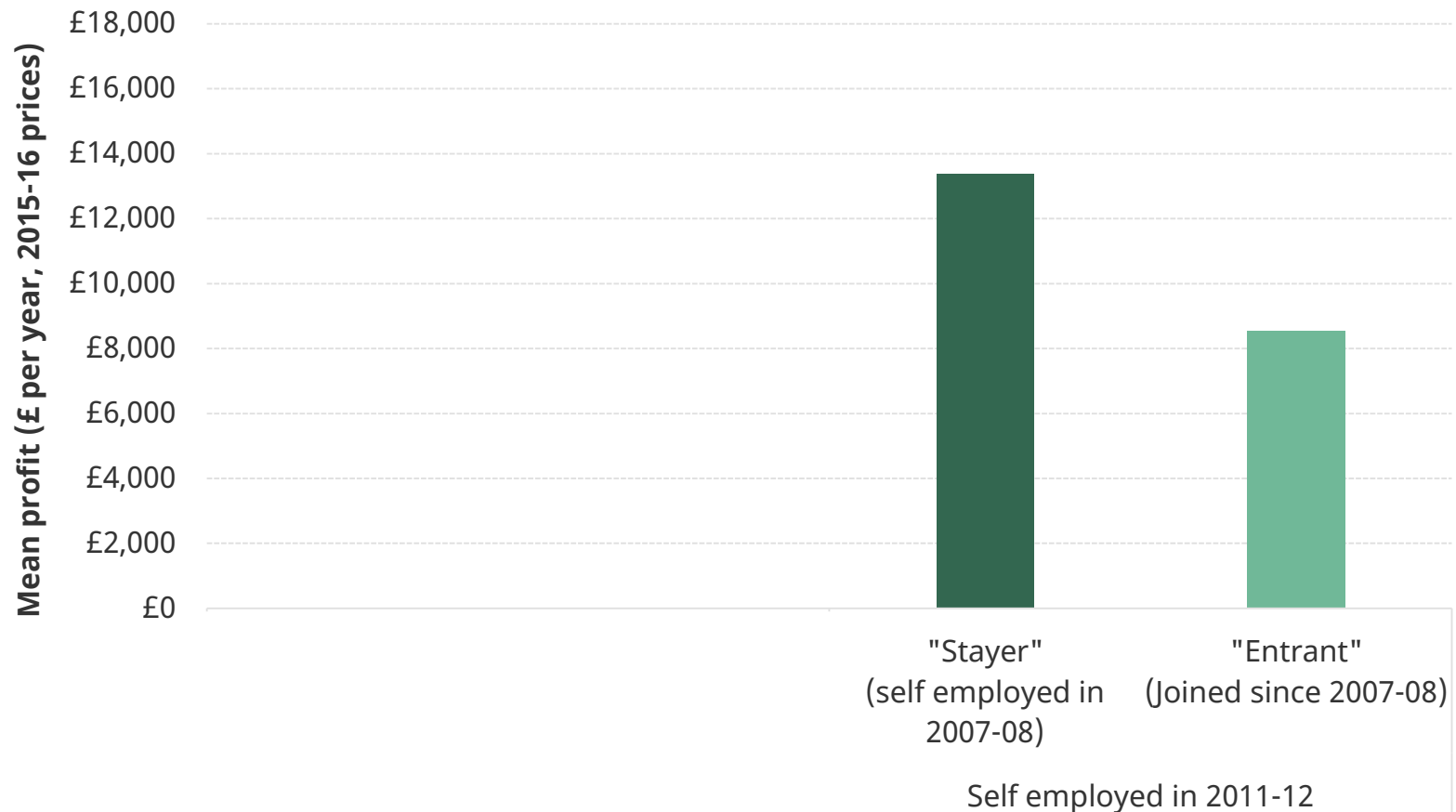


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# What drove the fall in profits 2007-08 to 2011-12?

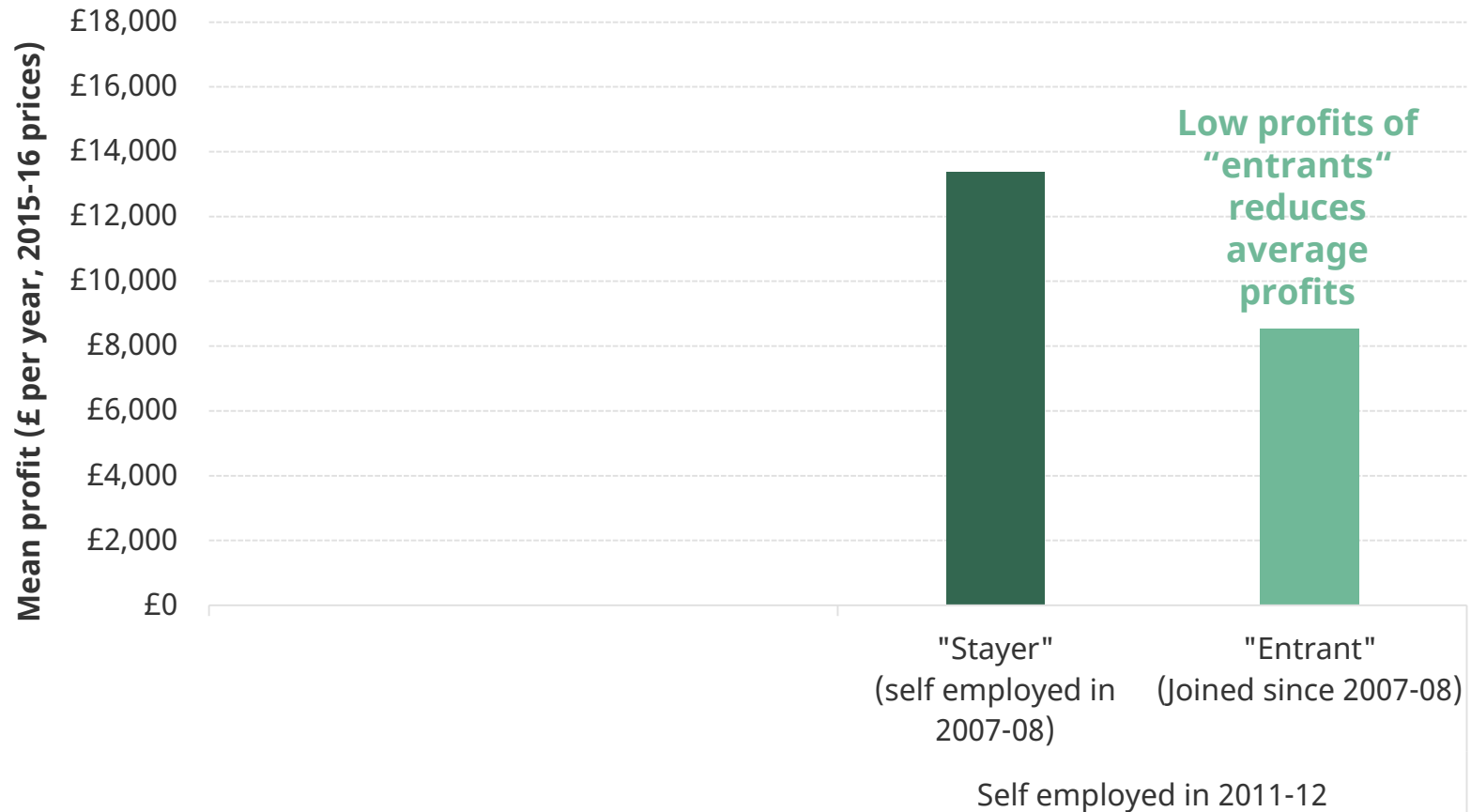


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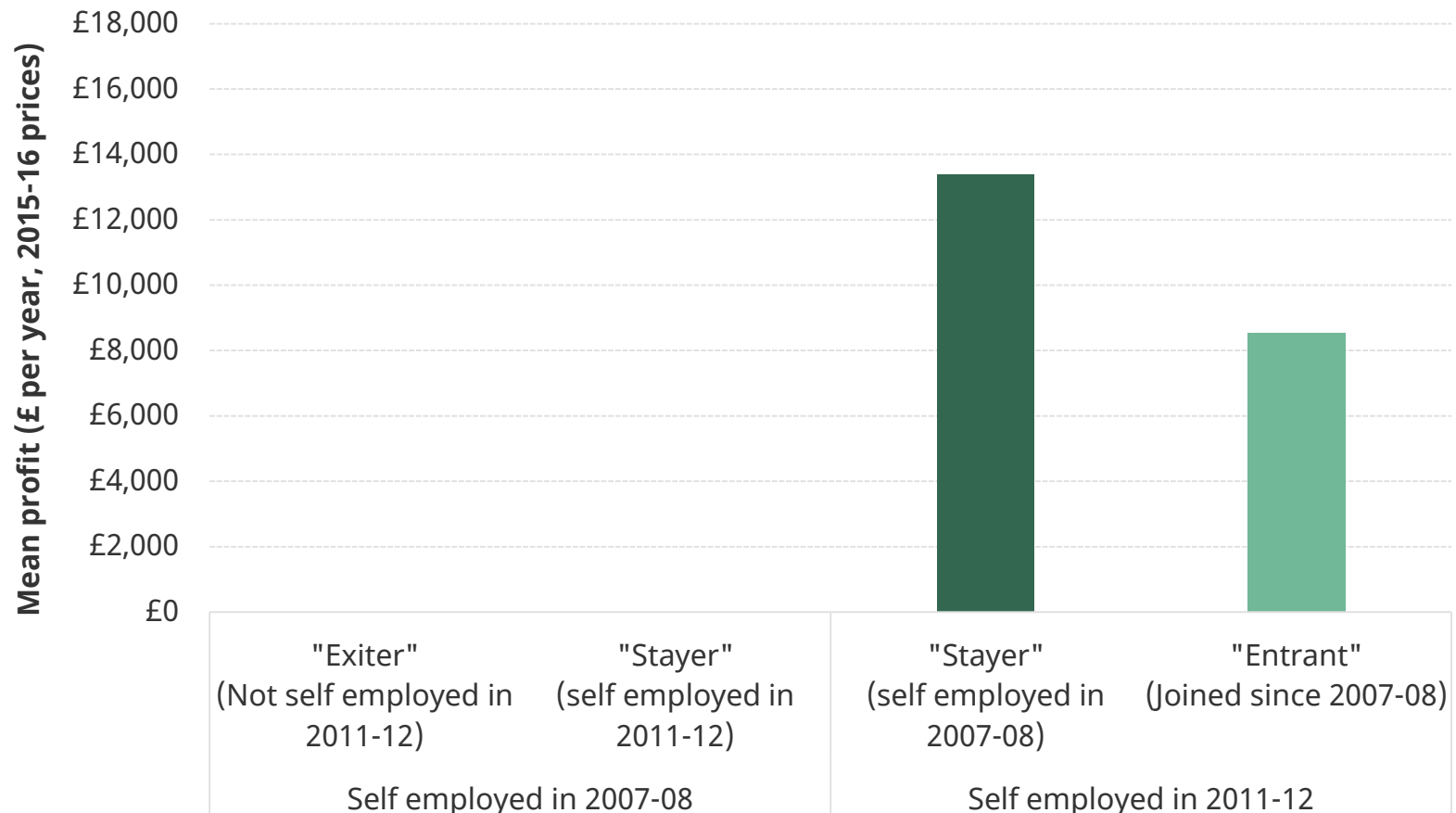




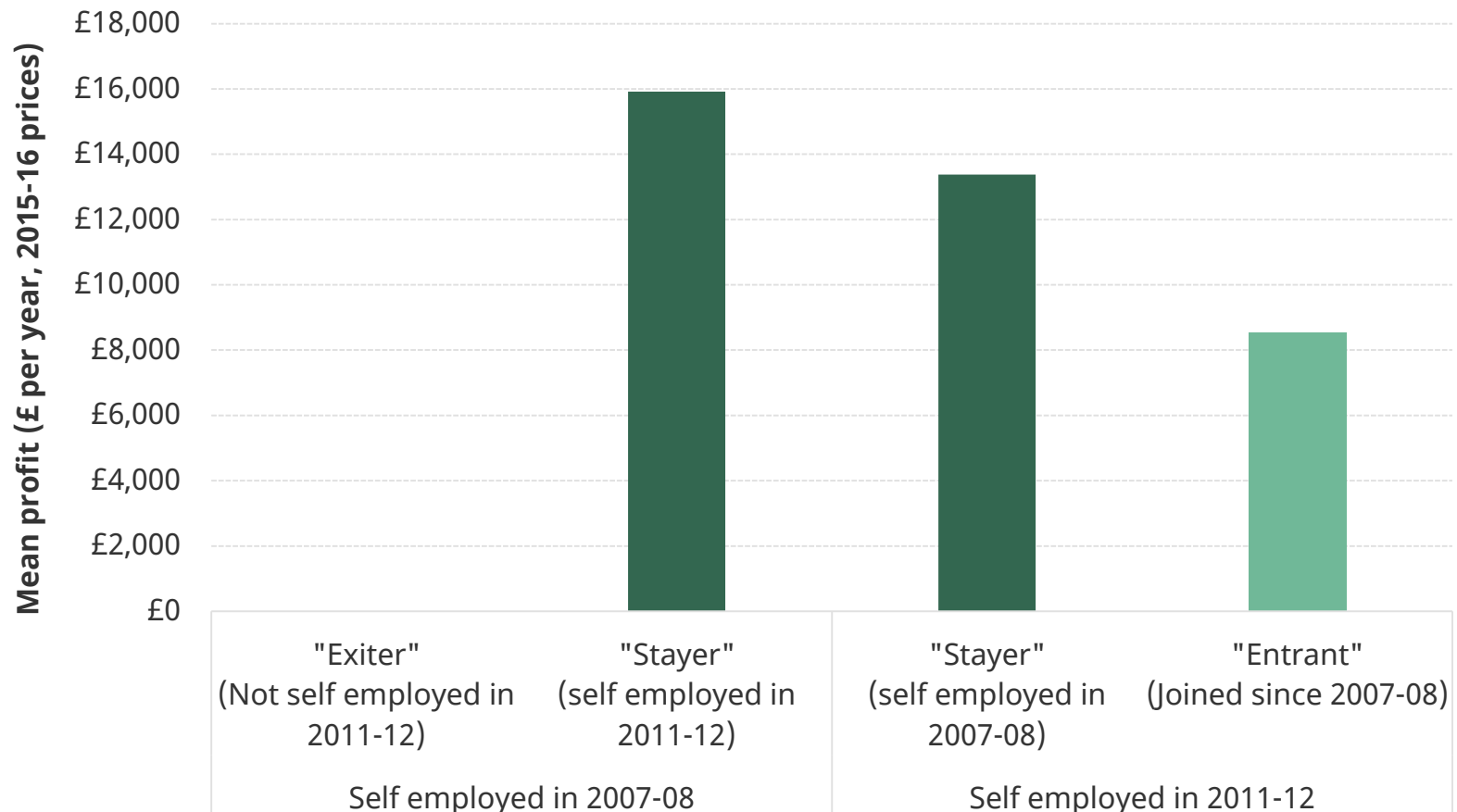
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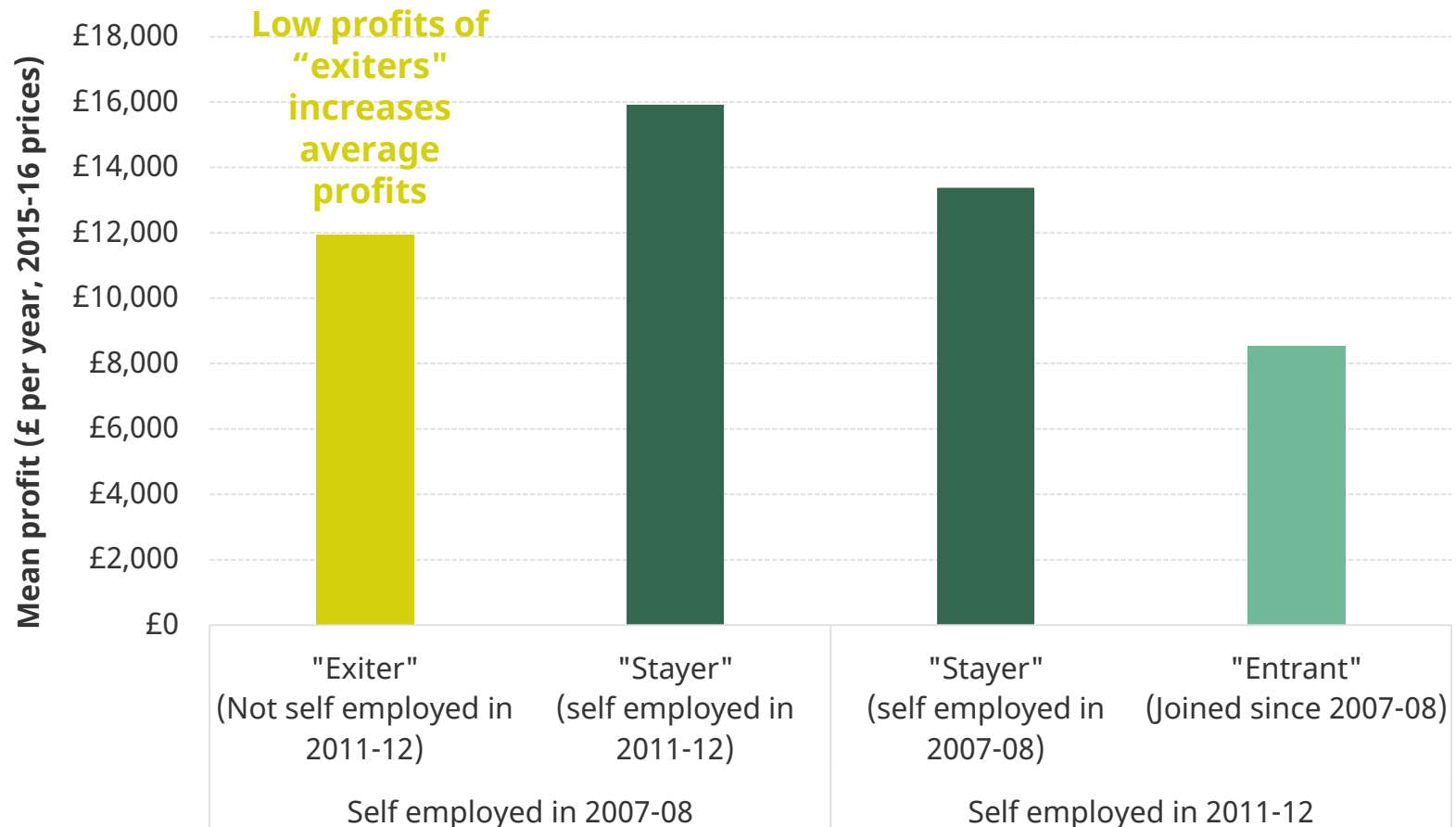
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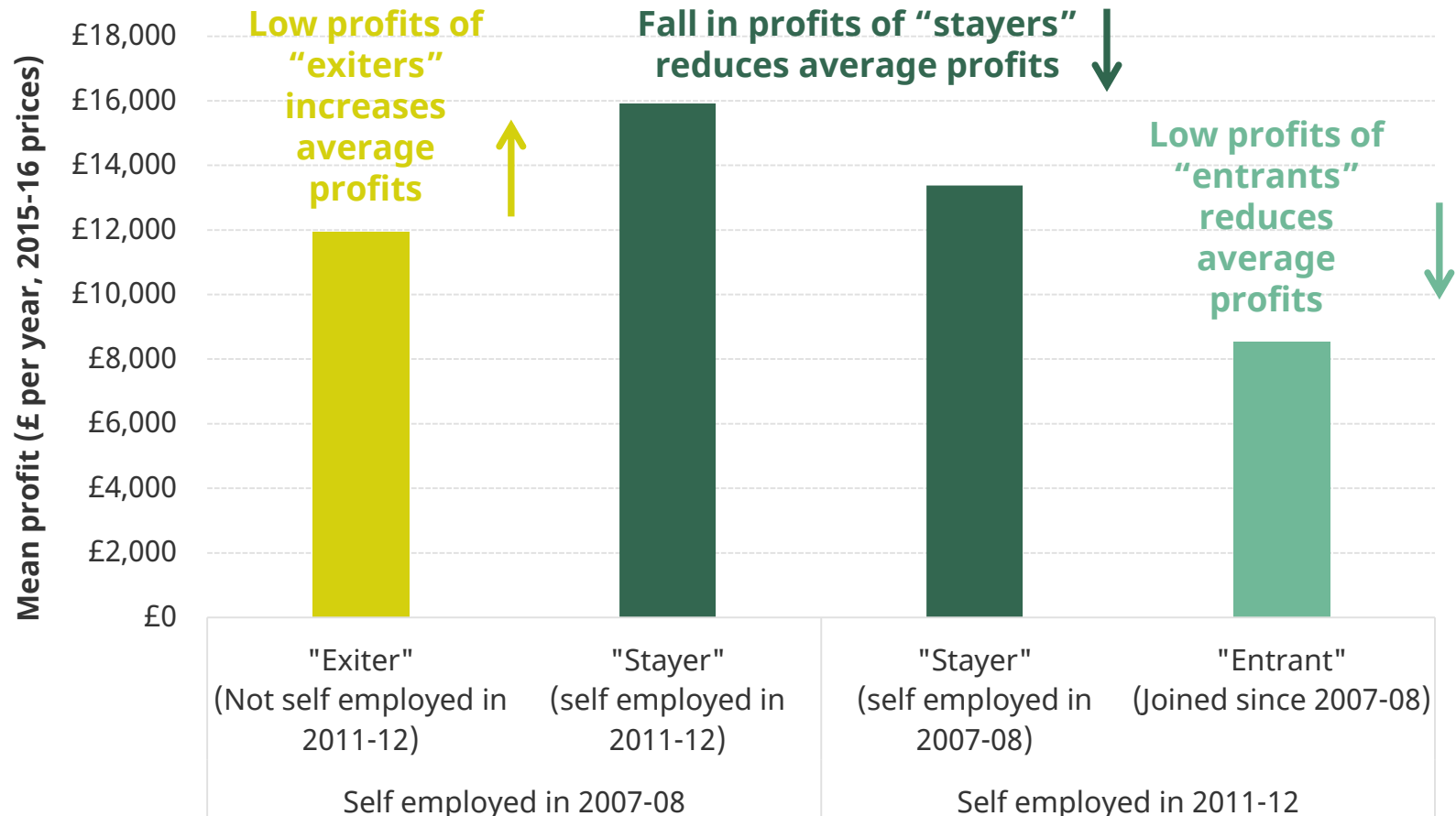
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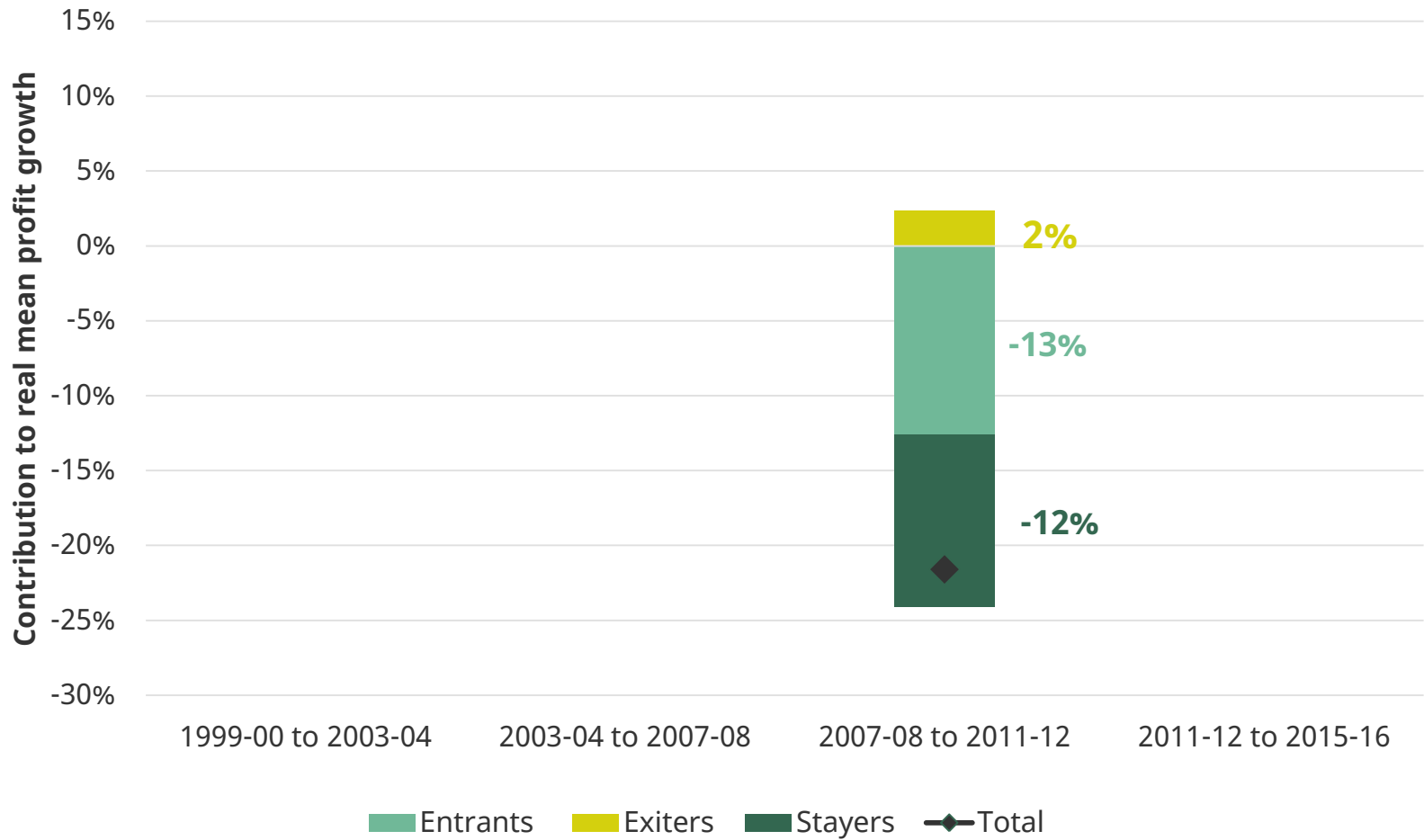
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# Decomposing changes in profits



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# Summary: Falling self employed profits in aftermath of the Great Recession

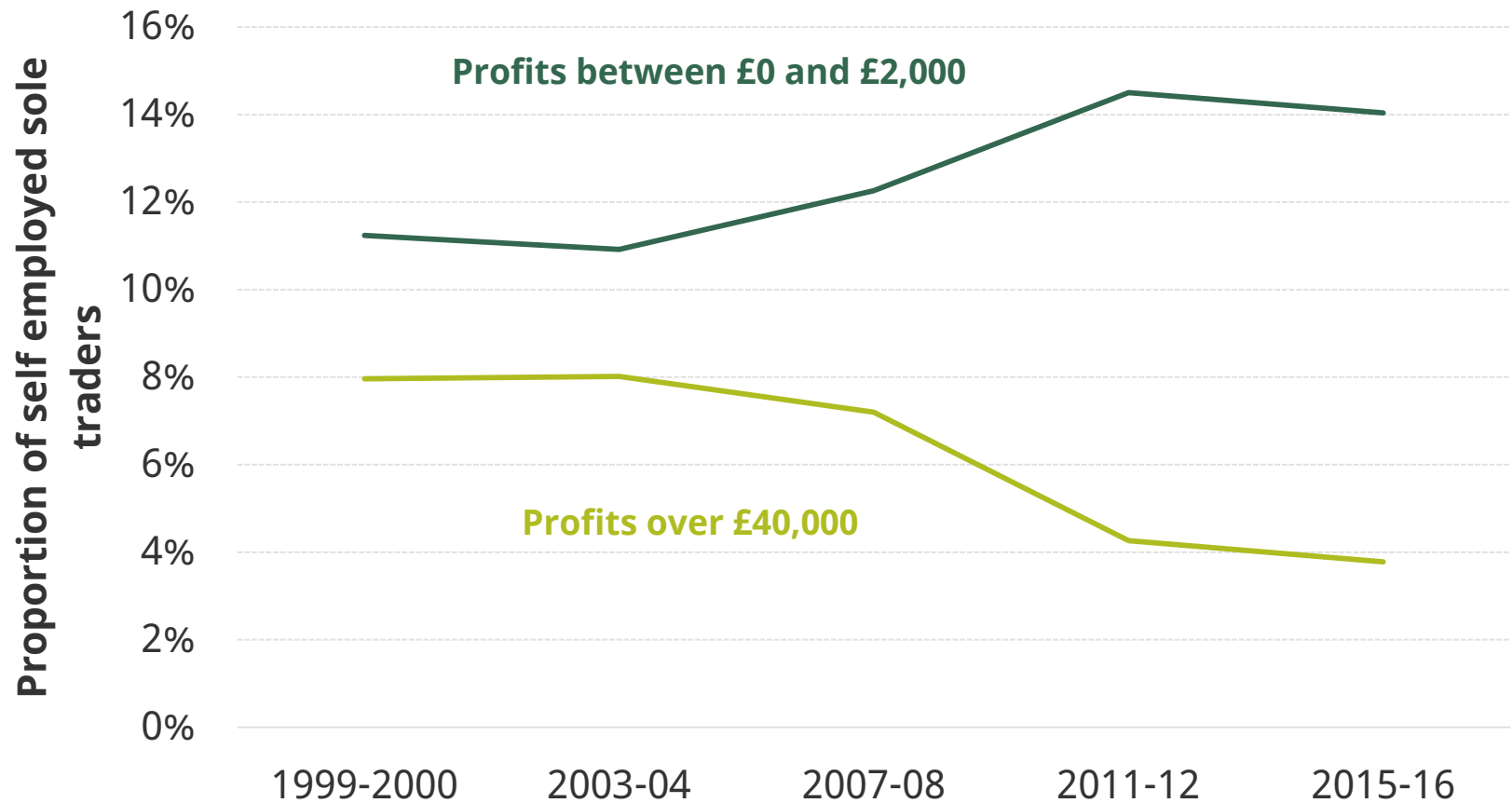
## Average (mean) profits of self employed sole traders 21% lower in 2015-16 than 2007-08 after adjusting for inflation

- 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

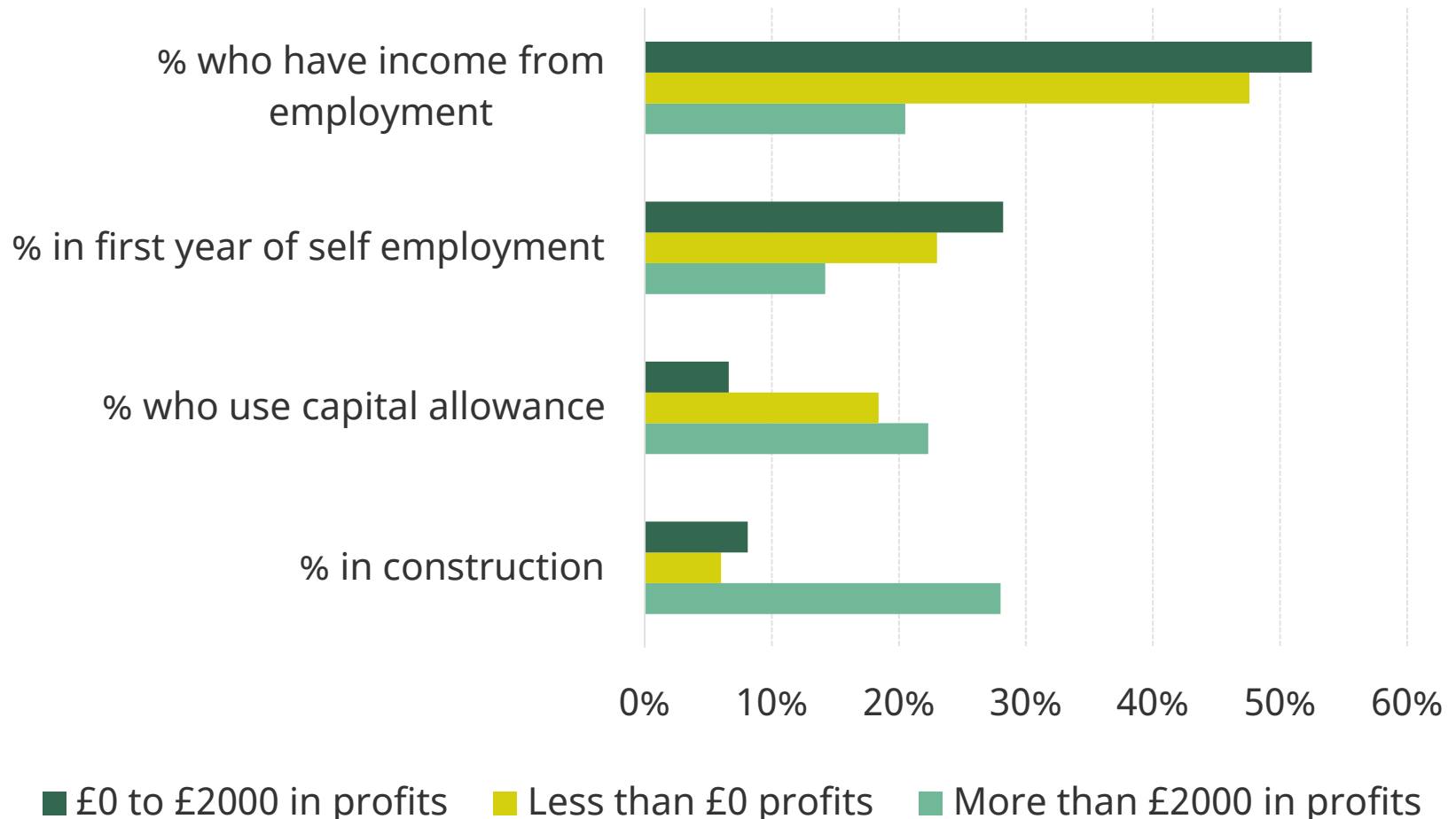


# Self employed sole traders with low profits

## 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

# Characteristics of sole traders with very low profits in 2015-16



# Self employed sole traders with low profit

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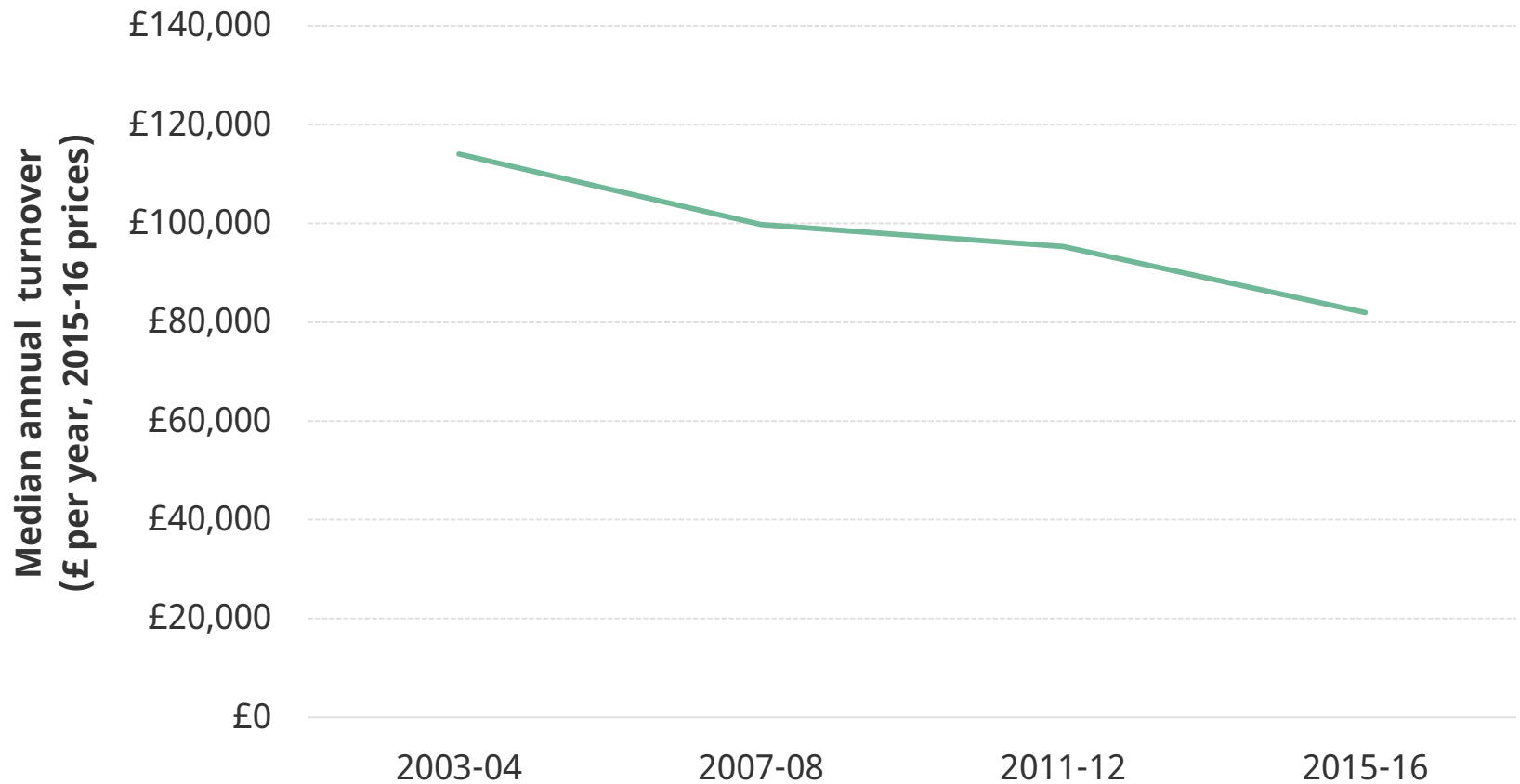
- Look very different on a range of measures to those with higher or lower profits
- Seem consistent with them undertaking self employment in a much less intense way
- Could this be consistent with a rise in “gig economy” workers or “kitchen table businesses”?
  - Low hours of work and little capital 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...

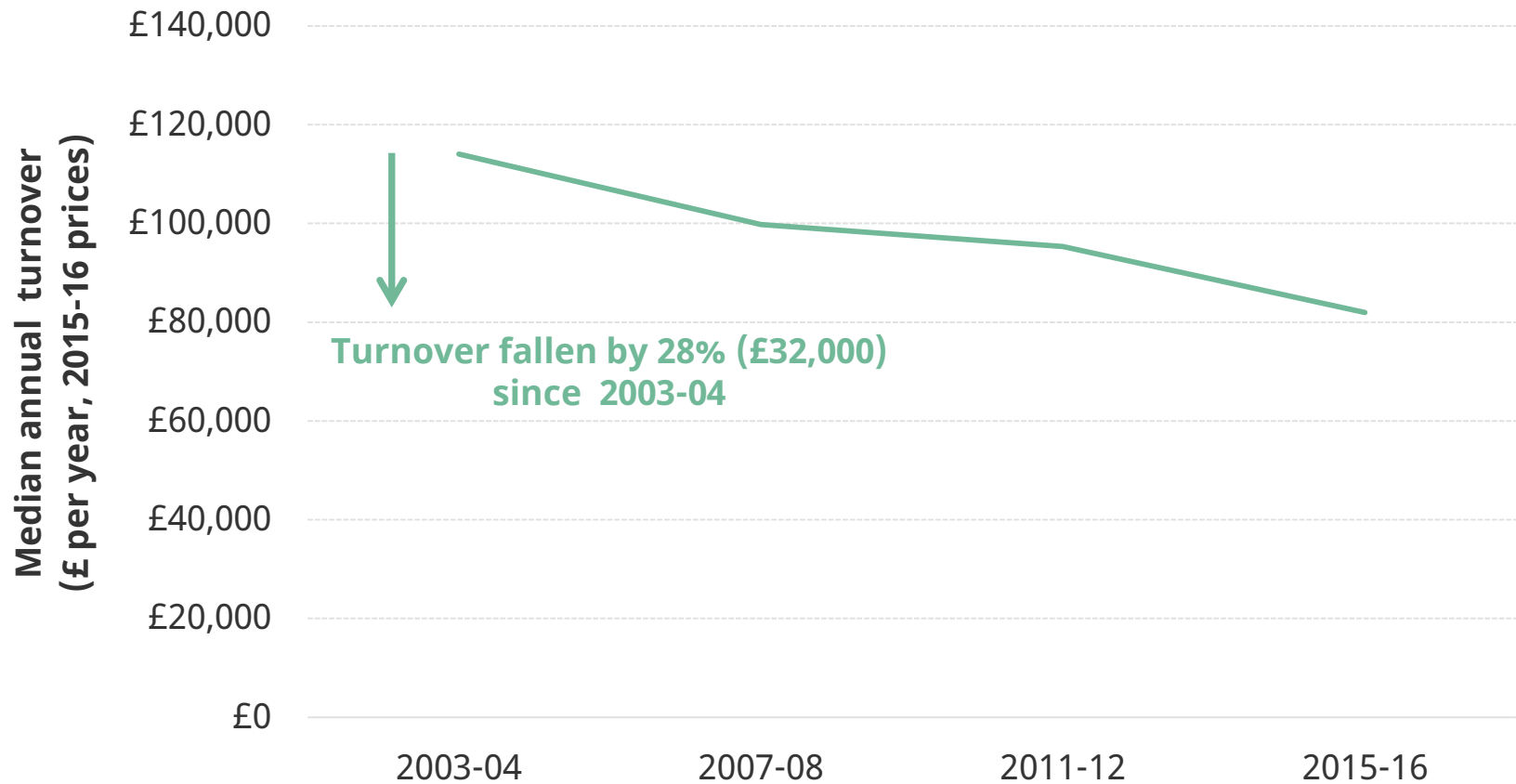
# Substantial falls in turnover for self employed with high profits



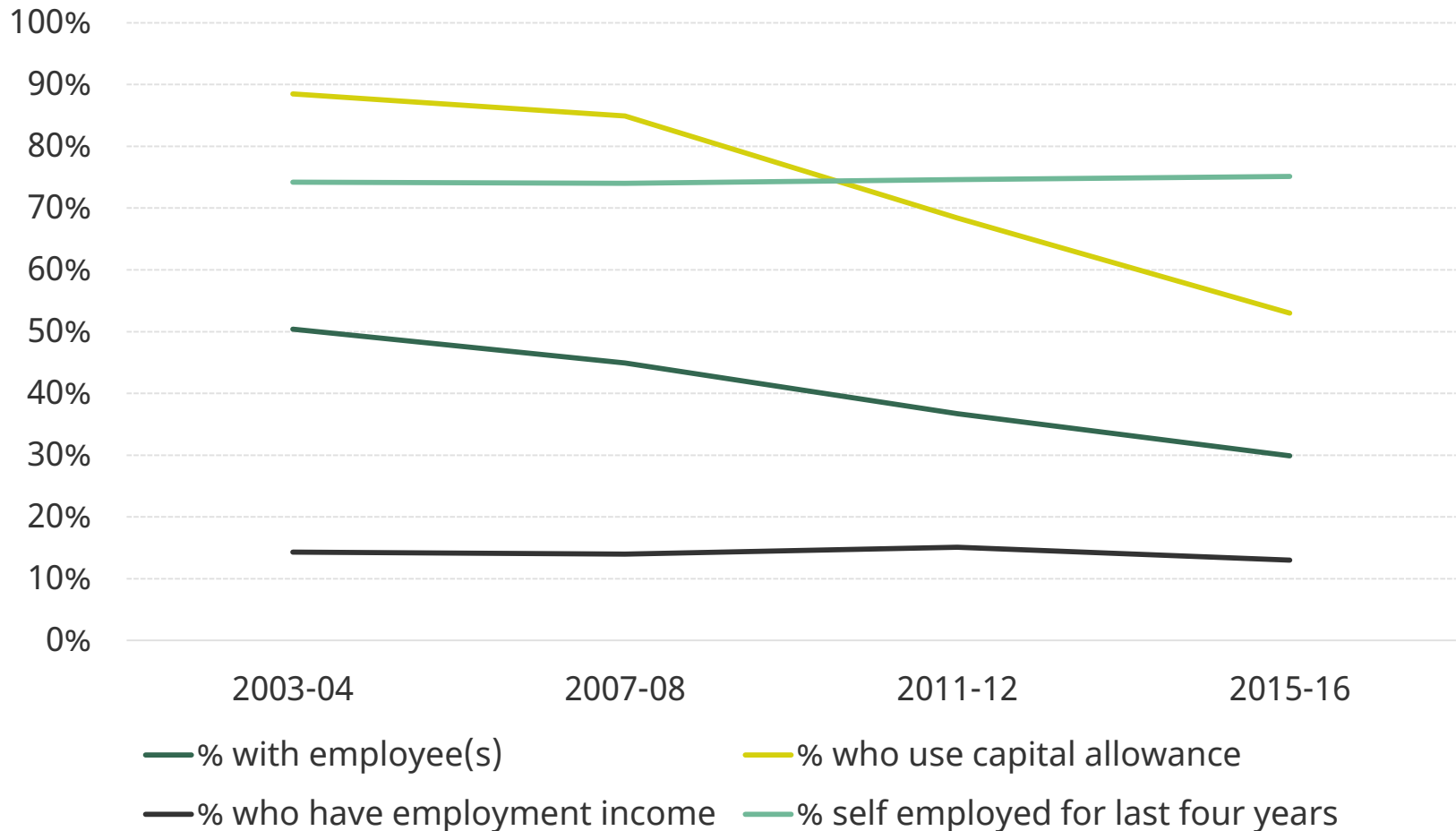


# Substantial falls in turnover for self employed with high profits

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



# Changing characteristics of self employed sole traders with earnings of at least £40,000



# Self employed sole traders with high profits

## 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