CHANGE

Changing work, changing incomes: designing a responsive social protection system for all

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Professional Perspectives on Self-Employed Financial Risks

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The CHANGE project

The CHANGE project is a research project between the Herman Deleeck Centre for Social Policy (CSB, University of Antwerp, coordinator), the Centre for Public and Social Law (CDPS, Université Libre de Bruxelles), and the Centre for Sociological Research (CESO, KU Leuven).

This collaborative initiative is driven by a partnership between academic institutions and funded by BELSPO, the Belgian Science Policy Office under the BRAIN-be program. The core mission of the project is to comprehensively examine and address the challenges faced by non-standard workers within the social protection system. These workers, including the self-employed, part-time employees, fixed-term workers, and those engaged in hybrid work arrangements, often experience gaps in social security coverage. The project exploits existing survey and register data sources. Also, it gathers new data on a broad and diverse group of non-standard workers, including different types of self-employed workers and atypical employees. This will enable us to understand the various (and often common) challenges they are confronted with, such as substandard coverage by social protection and fluctuating incomes.

https://www.uantwerpen.be/nl/onderzoeksgroep/csb/onderzoek/projecten/change/

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CHANGE Working Paper 2

Professional Perspectives on Self-Employed Financial Risks

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Abstract

This report presents the findings from the first research task within Work Package 2 (WP2) of the CHANGE project, focusing on income volatility and poverty risks among self-employed individuals. Given that the income formation of self-employed persons differs markedly from employees, traditional income-based assessments often fail to capture their vulnerability. The study involved consultations with six accountants and tax experts, who shared insights into the strategies self-employed individuals use to manage income uncertainty and safeguard their living standards. Key findings suggest that financial planning, including insurance, expense management, and corporate structure, plays a vital role in mitigating risks. Indicators of vulnerability include payment arrears, debt accumulation, and lack of access to financial advice. The study also highlights the importance of family circumstances, such as home and vehicle ownership, in assessing financial stability. These insights will inform future in-depth interviews and contribute to the development of a questionnaire aimed at improving the quantitative understanding of poverty among non-standard workers.

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WP 2 of the CHANGE project: What do incomes mean for non-standard workers?

WP2 explores the importance of different sources of income, especially incomes from a labor market related activity, for non-standard workers. The assumption is that income concepts usually used in surveys to measure poverty and social exclusion might be less relevant for non-standard workers in a changing world of work. A yearly income concept might be useless to gauge living standards in case of irregular monthly incomes, while an after-tax measure of income might be less relevant for self-employed whose profits are invested in their companies. Other non-standard workers then may try to optimize their salaries in other ways unobservable through surveys.

This WP lays the groundwork for the first research objective of the CHANGE project, i.e. improving our understanding and measurement of non-standard earnings, and will feed into research objective 2, i.e. the disentanglement of the link between income, living standards and social protection rights. This WP serves as important input to the empirical analyses in pillar 2 (WP3, and especially, WP4). WP2 aims to define income and living standard concepts that are relevant to non-standard workers, and that can also be quantitatively developed and analysed in the course of the research project. In addition, WP2 aims to understand how non-standard workers cope with volatile earnings, as well as understand additional (pecuniary) challenges with which they are confronted.

1. Introduction

This deliverable provides an overview of the findings from the first research task within Work Package 2 (WP2) of the CHANGE project. The central aim is to enhance our understanding of how non-standard workers, particularly the self-employed, navigate income uncertainty and volatility, and how poverty risks can be identified within this group despite the limitations of traditional income-based assessments.

Income formation for self-employed individuals differs significantly from that of employees. Factors such as tax avoidance, the deductibility of business expenses, and specific fiscal strategies can make low taxable income an unreliable indicator of living standards. Moreover, non-standard workers are much more likely than standard workers to face irregular monthly incomes. This means that our conventional understanding of poverty risks, based on a yearly disposable household income concept (Atkinson et al., 2002), may not adequately capture vulnerability among non-standard workers.

We consulted six accountants and tax specialists to gain deep understanding of the strategies adopted by self-employed to safeguard their living standards and what may be reliable indications of precarity and vulnerability. In other words, in what situations does a low taxable income reflect a poverty risk or not? These insights feed into deliverable 2.2 in which in-depth interviews with a wide range of non-standard workers and self-employed will be conducted to crosscheck the findings presented here. In turn, both deliverables will enable us to develop a questionnaire in which these strategies and indicators are operationalized in order to improve our quantitative understanding of poverty amongst non-standard workers and self-employed.

The sample of professionals consulted includes two accountants and four business leaders from consultancy firms. Among the latter are two individuals specializing in maximizing cash flow investment, one focusing on income software development, and one specializing in life insurance consultancy. We selected these profiles for their technical professional background and experience in assisting self-employed persons through business challenges, providing us with valuable insights into income optimization strategies. The interviewees were recruited through researchers' personal and online networks. All consultations took place online in fall 2023, lasting an average of 45 minutes. Consultations were carried out following the principles of the Chatham House Rule, which fosters open discussions without revealing speaker identities or affiliations, encouraging unrestricted dialogue.

2. Results

Safeguarding and mitigating risks

A key factor that emerged from the interviews is the necessity of preparation and safeguarding to mitigate risks. As self-employed activity is more volatile and less predictable in terms of earnings, self-employed individuals might need to plan ahead for rainy days. Accountants often recommend additional insurance, for instance replacement income schemes, as they offer fiscal deductibility. Consequently, the absence of such future financial planning could signal vulnerability. Nonetheless, not all financial planning schemes are considered essential. Insurance safeguarding against occupational disability may be strongly recommended. Pension insurance, on the contrary, might not be as enticing for younger entrepreneurs and is typically advised solely for individuals with substantial capital. One way to integrate risk mitigation is by factoring in expenses thoroughly. Charging fees that fail to cover business expenses, personal income tax, and contributions could therefore suggest a vulnerable position. Another indicator could be holding back personal remuneration for the benefit of the company.

An essential gauge of living standards lies within the family domain. To mitigate business-related risks, the family home is retained as a personal asset. This suggests that the family residence can effectively represent the standard of living. Whether one rents or owns their home further indicates this status. Similarly, owning a vehicle outright (i.e., not leasing) can also be indicative of one's standard of living. When examining the family dimension, it's important to pay attention to how family income is financed. This involves understanding whether the primary source of income comes from a partner working in wage labour or if the self-employed individual bears the majority of the household income burden. If the partner is involved in the self-employed individual's business, the family income may be reliant on a single source of income, which can increase financial risks since income diversification is limited.

Indicators of vulnerability

The push and pull factors behind setting up a business also vary according to income levels. Higher earners typically prioritize flexibility and wage optimization, while lower earners usually cite necessity as their main motivation.

An important indicator turned out to be payment arrears; when social contributions or VAT are not paid, or when they are paid by the company using business assets, this can be considered a warning sign. Having to resort to business assets for private spending can, in some cases, also indicate vulnerability. Furthermore, borrowing money within your own business can result in accumulating interest, potentially leading to a snowball effect of financial difficulties as the interest payments add up exponentially. However, with interest rates at 30%, this tactic can prove advantageous in circumventing social contributions and personal income tax, provided that timely repayment can be ensured. This implies that eligibility for this fiscal construct hinges on the amount of available capital. Those with greater capital resources who can leverage this arrangement will, proportionally, contribute less than those with fewer resources who cannot access its benefits. Conversely, individuals lacking capital may find themselves in a paradox, navigating a fiscal construct meant to alleviate burdens, inadvertently deepening their debt.

Regarding debt, the timeframe for paying suppliers can serve as an indicator of financial distress, with suppliers typically expected to be paid within 30 days (except for construction). Secondly, the debt ratio, with a higher ratio indicating a greater debt burden relative to income, can signal financial vulnerability.

Not unimportant is the type or corporation under which the business operates. Setting up a company is typically more organized and can be more fiscally advantageous than working as a natural person. Scholars have pointed out a phenomenon of corporatization *(vervennootschappelijking)* of the employment relationship, which is aimed at the cost optimalization of the fiscal and parafiscal arrangement (Coumans, 2023; Stevens & Put, 2018). Through corporatization, the tax burden on labour income can by reduced up to 30-35% and can result in a significant decrease in social contributions (Coumans, 2023), putting downward pressure on social security and tax revenue (Hoge Raad van Financien, 2020; Stevens & Put, 2018). As a result, solo self-employed individuals working as a natural person are more likely to experience vulnerability.

Another aspect of vulnerability pertains to financial and fiscal literacy. Individuals with a strong understanding of personal finance and fiscal matters might have greater awareness of and, thus, access to income optimization strategies. Consequently, having access to professional services like accountants and tax advisors may indicate lower levels of financial distress. For instance, not having an accountant or at least have access to professional advice could be an important indicator of financial vulnerability. In contrast, having the ability to access tax advisors could be indicative of financial capacity.

3. Summary of the results

Self-employed individuals face income volatility, requiring careful financial planning and safeguarding to mitigate risks. Key strategies include:

- **Insurance**: Replacement income schemes are fiscally deductible and commonly recommended. Occupational disability insurance is seen as essential, while pension insurance is usually suggested for those with significant capital or older entrepreneurs.
- **Comprehensive Expense Planning**: Professional fees ees must be structured to fully cover three essential components: business operating costs, tax obligations, and mandatory contributions. When self-employed individuals set fees below the threshold needed for these fundamental costs, it could indicate financial vulnerability.**Business vs. Personal Finance**: Withholding personal remuneration to benefit the company can suggest a precarious financial situation.

Family circumstances play a significant role in assessing living standards and financial health:

- **Home Ownership**: Retaining the family home as a personal asset (separate from business assets) serves as a risk mitigation strategy. The specific housing arrangement (whether renting or owning) provides additional context about financial status, though the implications may vary based on individual circumstances.**Vehicle Ownership**: Owning rather than leasing is another measure of living standards.
- **Family Income Structure**: A reliance on one partner's income or having a partner involved in the business may expose the household to greater financial risk due to limited income diversification.

The following potential signals and indicators of vulnerability emerged from the conversations:

1. **Motivations for Entrepreneurship**:
   - Higher earners value flexibility and wage optimization.
   - Lower earners often start businesses out of necessity, reflecting potential vulnerability.
2. **Payment and Debt Challenges**:
   - Payment arrears for social contributions, VAT, or suppliers (beyond 30 days) signal financial distress.
   - Business borrowing presents a dual nature: For those with sufficient capital, it can be a strategic fiscal optimization tool (at 30% interest rates). However, for those lacking capital, it may lead to deepening financial vulnerability through accumulated interest or debt snowball effect.
   - Debt must be evaluated within context - while high ratios can indicate financial strain, they may also reflect intentional fiscal strategy when properly managed.
3. **Corporate Structure**:
   - Solo self-employed individuals operating as natural persons are more vulnerable than those organized as corporations, which offer fiscal advantages like reduced labor tax burdens.
   - While corporatization (vervennootschappelijking) can offer fiscal advantages through reduced labor tax burdens and social contributions, this structure requires scrutiny to distinguish between genuine business operations and arrangements primarily designed for tax optimization. The variety of corporations should be considered as they allow unequal tax deductibility options.

Financial Literacy and Access to Services:

- Individuals with strong financial and fiscal literacy are better equipped to optimize income and manage risk.
- Access to accountants and tax advisors indicates greater financial capacity, while the absence of professional financial guidance suggests vulnerability.

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