

THEORETICAL OVERVIEW OF SELF-EMPLOYED PERSONS

*Ilze Sproģe , Aina Joppe , Irina Solovjova 

University of Latvia, Latvia

*Corresponding author's e-mail: ilze.sproge@lu.lv; aina.joppe@lu.lv; irina.solovjova@lu.lv

Abstract

Employment is a crucial indicator of economic development and growth, making employment policy a key component of national and regional socio-economic strategies. Self-employment is a significant form of employment widely practiced in Latvia and other EU Member States as a means to initiate businesses and integrate into the labour market. As of 2022, about 27.66 million self-employed individuals, constituting roughly 14% of the EU workforce, contribute to the European economy. Modern work dynamics allow individuals to earn income as employees or self-employed, with flexible employment forms, including self-employment, gaining popularity due to several advantages. These advantages include increased flexibility, personal independence, opportunities to join or stay in the labour market, and the potential to earn additional income alongside a primary job. However, self-employment also has its drawbacks. It can be exploited to evade taxes and bypass labour laws, leading to 'false self-employment'. While this may appear advantageous for the self-employed, it primarily benefits employers by reducing their costs. This practice can severely limit the self-employed's access to social protection and adversely impact their quality of life and financial stability in situations of social risk, such as illness, disability, or retirement. Self-employment involves various economic, psychological, sociological, and managerial dimensions and entails considerable risk. Global trends indicate that individuals in lower-income countries are more likely to be self-employed, whereas those in higher-income countries tend to have paid employment.

Key words: self-employment, independent workers, taxable status.

Introduction

Self-employment is a hot topic, related to more than 1.57 billion self-employed people worldwide. The self-employed account for half of all employees. Tax issues for the self-employed are complex, leading to various problems. These include difficulties in preparing tax returns, incorrect calculation of tax payments, insufficient information on tax reliefs and deductibles. There may be difficulties with paying social security contributions. Such problems often result from a lack of information, complex legal requirements or misinterpretation of information.

The theoretical aspect of self-employment covers a wide range of topics, from economics, sociology to psychology. It includes understanding how individual entrepreneurs build and manage their businesses, the motivations for self-employment, the challenges and the impact on the wider economy.

From an economic perspective, self-employment is seen as an important source of micro-entrepreneurship and innovation. Self-employment contributes to economic diversification, creates new jobs and stimulates competition. Theory also examines how self-employment is related to insufficient labour market flexibility or as a defence mechanism against unemployment. Simon C. Parker's study 'The Economics of Self-Employment and Entrepreneurship' offers a deep insight into the economics of self-employment, including motivations and potential risks (Parker, 2004).

Sociology studies self-employment as a social and cultural phenomenon in which individual goals, social networks, cultural norms and values play an important role. Entrepreneurship is seen not only as an economic activity, but also as a way for individuals to demonstrate their identity and values (The Psychology of Entrepreneurship, 2023). Researcher Mariana Mazzucato, in her study 'The Entrepreneurial State.

Debunking Private Sector Myths' looks at the role of the state in innovation and in supporting self-employment.

Psychology studies the personality traits, motivations and behaviour of the self-employed. Self-employment is often associated with high autonomy, notions of self-efficacy and a desire for achievement. Psychological factors can influence an individual's ability to start and successfully run their own business. Psychology Research Progress series provides an overview of the psychology of entrepreneurship, highlighting personality traits and motivation (The Psychology of Entrepreneurship, 2023).

The impact of legal structures and the tax system on self-employment is an important theoretical aspect influencing the design of the business environment. It also includes discussions on how public policies and regulation can facilitate or hinder the growth of self-employment (Gomez, Isakov, & Semansky, 2015).

Problem Statement: the existing tax frameworks for self-employed individuals in Latvia and other OECD countries are complex and inconsistent, leading to difficulties in compliance, inadequate social protection, and potential economic inefficiencies. While some countries have introduced simplified tax schemes and digital solutions, others lag behind, resulting in a competitive imbalance and varied entrepreneurial success rates.

The research aim is, on the basis of the studies of type of employment self-employed policy in Latvia, to compare it with other countries.

The following research tasks are subject to the aim:

- 1) to analyse statistics on self-employment in the world;
- 2) to demonstrate the importance of paying taxes on the income of the self-employed;
- 3) to develop recommendations for self-employment status and taxation.

The research basically covers the period from 2000 to 2024.

Materials and Methods

Research methods: the monographic and descriptive methods, analysis and synthesis, the graphic method and case studies from different countries. The present research is based on various scientific publications, publicly available documents, information available in databases and other sources.

The study mainly uses and analyses tax legislation from different countries focusing on real examples of taxation.

Results and Discussion

Global trends and self-employment taxation

Tax competition for the self-employed is an important issue when studying globalisation trends. Tax competition for the self-employed is a phenomenon that arises when countries seek to attract or retain entrepreneurs and the self-employed by offering particularly favourable tax regimes or incentives. Such competition is common across countries and regions of the world. There are a number of factors that influence tax competition for the self-employed (Martinez-Vazquez, 2021):

Tax rates

Some countries offer lower tax rates for the self-employed, which can attract self-employed workers and entrepreneurs from other countries or encourage existing entrepreneurs to stay at home.

Tax incentives and rebates

Countries can offer various tax incentives and rebates to the self-employed, such as reduced tax rates for the first years of business or exemptions from certain taxes in certain circumstances.

Business environment support

Some countries provide active support to entrepreneurs, for example, through free training, financial assistance or infrastructure for business development.

Administrative formalities

Countries that simplify administrative formalities for entrepreneurs and reduce red tape can be more

attractive to the self-employed.

Competitive tax policies can be positive, because they can stimulate economic development by attracting new entrepreneurs and boosting business activity. However, it can also have negative consequences, such as a lack of spending for the public budget (Hagen & Sørensen, 1994). It is therefore important that countries carefully consider and assess the long-term impact of competing tax policies and how this will affect their economic development and national budgets. To ensure fair tax competition, some countries have introduced international tax standards and cooperation initiatives to prevent tax evasion and avoidance (Gilkerson *et al.*, 2003).

International tax policy coordination for the self-employed is a topical issue. In an era of globalisation and the rise of digital businesses, international tax policy coordination is increasingly important to prevent tax avoidance and ensure fair competition.

‘Figure 1’ shows that the share of self-employed compared to the employed varies. Moreover, it depends on the economic situation of the country. By definition, the self-employed work for themselves, without recourse to wage labour. In Latvia, the number of self-employed who pay state social contributions is around 45,000.

In newly developed countries, the majority of people are poor and become self-employed to escape poverty (Self-employment and poverty in developing countries, n.d.).

When looking at the state of self-employment around the world, it is clear that there is in fact an inverse correlation between the share of self-employed workers and their countries’ GDP. According to the International Labour Organisation, only 12.2 per cent of workers are self-employed on average in high-income countries, while in low-income countries this figure rises to 80.3 per cent. This is a measure of the prevalence of subsistence farming and the number of people who work unpaid for their family businesses (also listed as self-employed in the data).

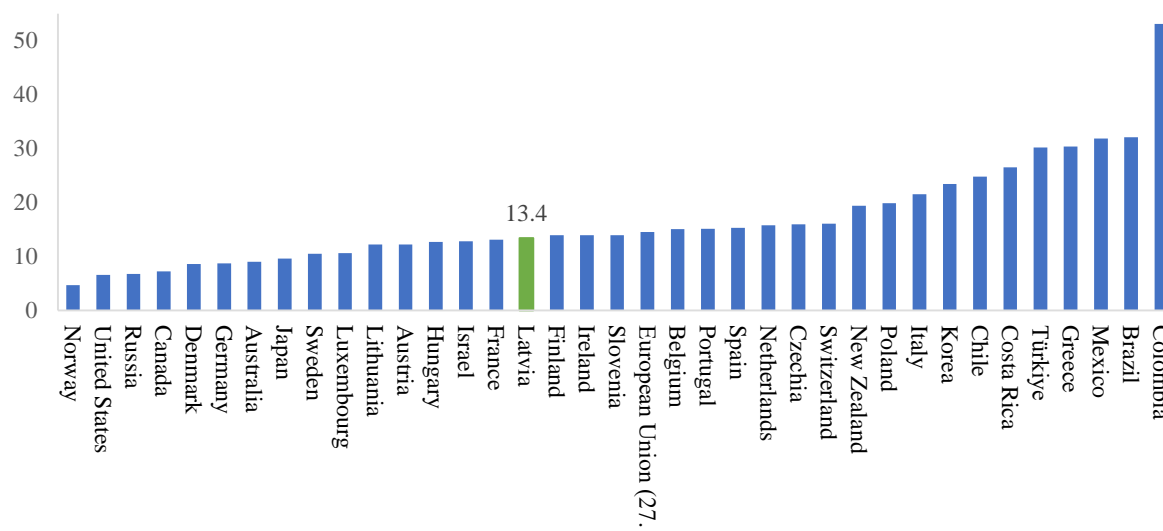


Figure 1. Self-employment rate 2022, % of total employment in OECD counties.

Source: OECD date. <https://data.oecd.org/emp/self-employment-rate.htm>.

In 2019, Niger had the highest self-employment rate in the world - over 95 percent. Arab countries had the lowest self-employment rates. 4.9 per cent of workers in the United Arab Emirates earned their wages independently in 2019. In Kuwait and Qatar, the figures were even lower - 1.8 per cent and 0.4 per cent respectively (Statista data, n.d.), see 'Figure 2'.

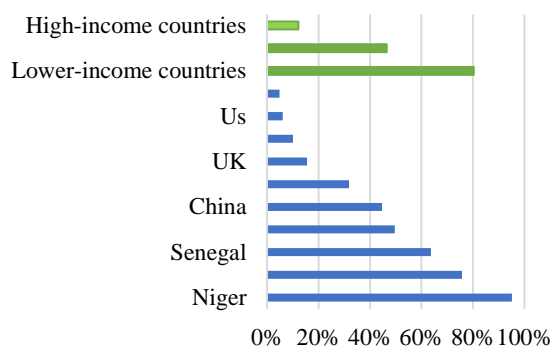


Figure 2. Self-Employed/independent workers rate 2019, as a share of the working population.

Source: Statistics / International Labour Organization via World Bank, <https://www.statista.com/chart/18908/self-employed-workers-by-country/>.

The Covid-19 pandemic, the cost-of-living crisis and the war in Ukraine have impoverished 165 million people over the past three years, the UN reported on Thursday. These shocks will have pushed 75 million people into extreme poverty earning less than \$2.15 (€1.92) a day between 2020 and the end of 2023, and another 90 million below the poverty line of \$3.65 (€3.26) a day, according to a study released by the UN Development Programme (UNDP) (LSM.lv).

Self-employment model in Scandinavian and Anglo-Saxon countries

The regulation of the self-employed in the Nordic and Anglo-Saxon countries offers two different approaches that influence the business environment, tax policy and social protection.

Broad social protection is the main feature of the Scandinavian model. For example, Sweden, Norway and Denmark offer extensive social protection, which includes sickness benefits, pensions, unemployment benefits and parental leave. Social protection systems are designed to ensure equal access to all labor market participants, including the self-employed (Ulmestig, 2013).

Scandinavian countries are characterized by a high tax burden. High income tax rates to fund extensive social safety net programs. The tax system promotes income redistribution to reduce inequality and support socially vulnerable groups (Engström & Holmlund, 2009).

The Nordic countries have introduced various programs and support measures to promote entrepreneurship and innovation. It also includes help and advice for the self-employed. The self-employed can count on stable social protection that reduces the risk associated with income fluctuations and ensures greater social equality and prosperity for all citizens.

The high tax burden may be a disincentive for some entrepreneurs seeking lower tax regimes.

The main features of the Anglo-Saxon model are the low tax burden. A simplified tax system exists in the USA, Great Britain and other Anglo-Saxon countries. The Anglo-Saxon model usually has lower tax rates and simpler tax administration procedures. A lower tax burden stimulates entrepreneurship and self-employment as it reduces the financial burden on entrepreneurs.

Social safety net programs are less extensive, and the self-employed are often responsible for their own health insurance and retirement savings. Less government intervention in the labor market and social safety net programs, allowing for greater flexibility (Simoes, Crespo, & Moreira, 2016).

Anglo-Saxon countries have fewer regulatory barriers, making it easier to start and run a business. Various public and private initiatives are available to provide financial and advisory support to entrepreneurs (Yuen *et al.*, 2018).

The authors come to the conclusion that a lower tax burden makes these countries attractive to entrepreneurs and investors. Greater flexibility and fewer regulatory barriers encourage innovation and rapid adaptation to market changes.

Less social protection may lead to greater economic insecurity for the self-employed, especially in crisis situations. Less income redistribution can contribute to greater social and economic inequality.

The authors conclude that both the Scandinavian and Anglo-Saxon models have their own advantages and disadvantages, and each model offers different solutions for promoting and regulating self-employment. The Nordic model is characterized by strong social protection and equality, but with a higher tax burden, while the Anglo-Saxon model offers lower taxes and greater flexibility, but with less extensive social protection. The choice between these models depends on the political, economic and social priorities of each country.

In Latvia, 418,000 or 22.5% of the population were at risk of poverty in 2021 - 0.9 percentage points less than in 2020, according to the 2022 population survey conducted by the Official statistical portal (Oficiālais statistikas portāls), their disposable income was below the poverty line.

The authors explore how to promote the transition of the unemployed to self-employment and what strategies and policies to use. To encourage the growth of self-employment, support is needed from the state, from local authorities and from non-governmental organisations. The authors propose important steps that can help the unemployed to become self-employed:

- *Entrepreneurship training programmes* providing knowledge on business planning, financial management, marketing and sales. Such programmes are often offered by publicly

supported institutions or private organisations (Osterwalder & Pigneur, 2010).

- *Online courses* from platforms like Coursera, Udemy or Khan Academy, which offer a wide range of courses on entrepreneurship and specific skills.
- Seed capital from public funds, European Union programme support or microfinance institutions to help with start-up costs (Ries, 2011).
- *Tax breaks and subsidies* for start-ups to reduce the financial burden in the first years of operation.
- *Mentoring programmes* that connect young entrepreneurs with experienced mentor entrepreneurs, giving them the opportunity to learn from the experience and mistakes of others.
- *Business incubators* that provide not only financial support but also office space, mentoring and access to investment networks.
- *Entrepreneurship promotion* policies that facilitate business registration, tax payment and other administrative processes.
- *Sector-specific support programmes* that stimulate demand in priority sectors by offering specialised support and training.

Promoting these initiatives and resources can help the unemployed not only to become self-employed, but also to start their own businesses and become entrepreneurs in the future.

Taxation and self-employment

The study found that governments should support self-employment as a means to create livelihood opportunities for the poor and expand earning opportunities. Too often, government policies discourage the self-employed and, if policies are right, the self-employed can increase their incomes and lift themselves out of poverty.

Tax implications for the state budget

An examination of the taxation of the self-employed in individual countries (China, Japan, Austria, USA) shows that most countries impose personal income tax, national social security contributions and value added tax on the self-employed. Let us examine each of these taxes:

Income tax contributions: self-employment income makes up a significant part of the country's total tax revenue. The higher the number of self-employed and the higher the level of their income, the higher the income tax revenue for the state budget.

- *VAT contributions:* Self-employed persons who sell goods or services are responsible for collecting and paying VAT. This tax is an important source of revenue for the national budget, contributing to the share of consumption tax revenue.
- *Social security contributions:* Social security contributions paid by the self-employed help finance a wide range of social services, including pension and health care programmes. Contributions are vital to ensure the long-term financial sustainability of these programmes.

Tax policy is also much discussed in OECD research: the Organisation for Economic Co-operation and Development (OECD) regularly conducts research on

the economic impact of tax policy, providing recommendations and analyses of tax systems around the world.

Alternative taxation for the self-employed and innovative solutions

The authors carried out a study from different countries to explore alternative tax models for the self-employed in order to simplify the tax process, reduce the administrative burden and promote fair and efficient tax collection. Alternative taxes are designed to ease the tax burden and simplify tax administration for the self-employed:

- *Flat tax:* a simple tax system with a single fixed rate for all income, regardless of its amount. This model can simplify the tax calculation and declaration process for the self-employed (Mitchell, 2006).
- *Automatic withholding* may apply to self-employed workers who provide services to businesses. The company withholds the tax from the time of payment and transfers it to the Treasury, reducing the administrative burden for the self-employed.
- *Simplified annual tax:* An alternative model that allows the self-employed to pay tax on the basis of annual income rather than detailed records of expenditure and income (Bartlett, 2012).
- *Tax credits and incentives:* tax incentives for investments in innovation, education or other development activities. Such incentives can encourage business and personal development.
- *Digital tax remittance:* using modern technologies such as blockchain and artificial intelligence to automate the calculation and payment of taxes, reducing the likelihood of errors and fraud (Fichtner & Feldman, 2015).
- *Micro-enterprise tax.* In some countries, self-employed and micro-businesses have the option of paying a special micro-business tax which combines several taxes into one simplified payment.
- *Patent payment.* A patent payment is a fixed annual payment that allows a self-employed person to carry out an economic activity in a specific field without the complexity of calculating and declaring taxes.
- *Fixed monthly payment.* In some countries, self-employed workers can pay a fixed monthly payment that includes all taxes and social contributions, thus facilitating tax administration.

Innovative solutions for self-employed taxation can include various technological and procedural improvements aimed at simplifying the tax process, improving financial planning and providing user-friendly access to information (Tyson, 2015). These solutions can significantly reduce the administrative burden of taxation and help the self-employed manage their finances more effectively.

Based on the research carried out, the authors propose some of these innovative solutions:

- *Digital accounting software*: Software that automatically records income and expenses, calculates taxes and prepares tax returns, such as QuickBooks, FreshBooks and Xero. These types of solutions allow the self-employed to manage their finances and taxes more efficiently.
- *Cloud computing*: allows self-employed workers to access their financial data and accounting information from any device with an internet connection, providing flexibility and mobility.
- *Payment integration*: integrating payment systems with accounting software can automate income recording and reduce the need for manual entries.
- Offers personalised tax advice based on user data and using artificial intelligence algorithms. This can help identify tax savings and optimisation opportunities.
- *Online tax advice platforms*: provide access to professional advice online, offering a convenient way to get specific advice and answers to questions (Kohler, 2015), and offers courses on accounting, tax planning and financial management tailored to the self-employed.

Main problems in self-employment taxation:

- **Tax complexity and bureaucracy**. Tax systems are often complex and require a significant investment of time and resources to understand and comply with the requirements. This can be particularly problematic for the self-employed, who must take full responsibility for tax calculations and payments.
- **Tax burden**. The self-employed often have to pay both personal income tax and social security contributions, which together can result in a high tax burden compared to wage earners. This can create financial pressure and motivation to operate in the informal economy to avoid taxes.
- **Irregular income**. The self-employed often have irregular income, which can make accurate tax calculation and planning difficult. This can make it difficult to maintain liquidity and pay taxes on time.
- **Insufficient information and support**. Many self-employed people lack knowledge of tax laws and obligations. Insufficient access to information and support can lead to errors in tax returns and increase the risk of penalties.
- **Lack of social protection**. The self-employed often do not receive the same social protection guarantees as wage earners, such as sickness benefits or pensions. The high tax burden can seem particularly unfair if the social protection system is not equivalent.

Conclusions

1. The taxation of the self-employed in different countries is an important aspect influencing the business environment, economic activity and individual motivation to start a business.

2. Global trends and policies indicate how countries support the self-employed, how taxation is applied, what the new perspectives are and what the challenges are.
3. Tax contributions from the self-employed are an important source of revenue for the national budget, as they include both direct taxes, such as income tax, and indirect taxes, such as value added tax (VAT) on the sale of goods and services. In addition, depending on the country, self-employed workers may also pay national social security contributions.
4. Digitisation and automation are important and more and more countries are introducing digital tax return systems for the self-employed, which automate many manual processes, reducing the administrative burden and making it easier to pay taxes.
5. In an era of globalisation and the rise of digital businesses, international tax policy coordination is increasingly important to prevent tax avoidance and ensure fair competition.
The taxation of the self-employed is a major issue that requires attention from both policymakers and the self-employed themselves. Simplification of the tax system, tax incentives, better information and education, more flexible payment mechanisms and improved social protection can help to alleviate these problems and promote business development.

Proposals

To improve self-employment the government should focus on key challenges:

1. Evaluate the introduction of alternative taxation for the self-employed to simplify the tax payment process, reduce the administrative burden and promote fair and efficient tax collection, and facilitate the tax calculation and declaration process for the self-employed.
2. Introduce automatic withholding tax. Automatic withholding tax can be applied to the self-employed who provide services to businesses. The company withholds the tax from the moment of payment and transfers it to the Treasury, reducing the administrative burden for the self-employed.
3. Introduce simplified tax schemes. Some countries have introduced simplified tax schemes for small businesses and the self-employed, offering lower tax rates or simplified ways of calculating taxes to encourage entrepreneurship.
4. Explore tax incentives for the self-employed. In some countries, tax incentives and other incentives are available to support new entrepreneurship, innovation and the use of green technologies among the self-employed.
5. Introduce digitisation and automation. More and more countries are introducing digital tax return systems for the self-employed, which automate many previously manual processes, reducing administrative

- burdens and making it easier to pay taxes.
6. Simplify tax schemes: some countries have introduced simplified tax schemes for small businesses and the self-employed, offering lower tax rates or simplified ways of calculating taxes to
 7. Evaluate the integration of social protection. Integrate the self-employed into social security systems, offering them equal access to health care, pensions and other social protection programmes.

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