

CALCULATING LOSS OF EARNINGS  
TO THE SELF-EMPLOYED IN PERSONAL  
INJURY ACTIONS

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**Smith & Williamson**

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- **INTRODUCTION**
- **CASE STUDY**
  - 1 - S ERIKSSON - INITIAL REVIEW, MINIMAL INFORMATION
  - 2 - S ERIKSSON - QUESTIONS & FURTHER INFORMATION
- **POSSIBLE EXTERNAL FACTORS**
- **OTHER ISSUES**
- **STANDARD INFORMATION REQUIRED**
- **QUESTIONS**

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**INTRODUCTION**

**A self-employed individual calls you to say he has incurred a loss of earnings.**

**What information do you request from him to assess whether he has incurred a loss?**

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**INTRODUCTION**

A pro-forma Profit & Loss Account:

	£
Turnover	30,000
Cost of Sales	<u>(15,000)</u>
Gross Profit	15,000
Expenses	<u>(10,000)</u>
Net Profit	<u>5,000</u>

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**CASE STUDY – PART 1**

**Basic Information:**

Accident date 1 June 2004  
Returned to work 1 December 2004 (50% capacity)  
Returned to 100% capacity 1 April 2005  
Self-employed Roofer

**Summary:**

Absent from work for 6 months

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**CASE STUDY – PART 1**

You have been provided with a brief summary of his accounts for pre and post accident (Sheet 1).

The Claimant has requested a 'ball-park' estimate of his loss, based on this summary.

Prepare estimate (Assume Tax & NI at 30%)

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**CASE STUDY – PART 1**

	Scenario 1 Using 2004 £	Scenario 2 Using Ave £
Potential Net Profit	29,667	27,499
Actual Net Profit	<u>6,895</u>	<u>6,895</u>
Loss of Net Profit	22,772	20,604
Less Tax & NI	30% <u>6,831</u>	<u>6,181</u>
<b>Loss of Net Earnings</b>	<b><u>15,941</u></b>	<b><u>14,423</u></b>

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**CASE STUDY – PART 2**

You now have his full Profit & Loss accounts for pre and post accident (Sheet 2.1).

Review these accounts and list questions you would ask the Claimant for further information and explanations of trends.

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**CASE STUDY – PART 2**

	£	
Loss of Turnover	26,167	June to November 2004
Sub-contractor costs	4,000	December 2004 to March 2005
Saving in Materials	<u>(5,233)</u>	20% of Lost Turnover
<b>Loss of Gross Profit</b>	<b><u>24,934</u></b>	

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**CASE STUDY – PART 2**

	£
Overheads:	
Additional Miscellaneous expenses	1,100
Saving in Motor expenses	<u>(1,200)</u>
<b>Net Saving in Overheads</b>	<b><u>(100)</u></b>

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**CASE STUDY – PART 2**

Loss in Gross Profit	24,934
Net Saving in Expenses	<u>(100)</u>
Loss of Net Profit	24,834
Tax & National Insurance, at 30%	<u>(7,450)</u>
<b>Net Loss of Earnings</b>	<b><u>17,384</u></b>

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**CASE STUDY – SUMMARY**

	Scenario 1 Using 2004 £	Scenario 2 Using Ave £	Based on All Info £
Potential Net Profit	29,667	27,499	31,729
Actual Net Profit	<u>6,895</u>	<u>6,895</u>	<u>6,895</u>
Loss of Net Profit	22,772	20,604	24,834
Less Tax & NI	<u>6,831</u>	<u>6,181</u>	<u>7,450</u>
<b>Loss of Net Earnings</b>	<b><u>15,941</u></b>	<b><u>14,423</u></b>	<b><u>17,384</u></b>

Check Credibility of Answer (Sheet 3.3)

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**BE WARY OF EXTERNAL FACTORS**

- Reliance on / loss of one or more key customers
- Sales Day Book/Cash Book
- Increased competition
- Local knowledge/news
- Restricted supplies / increased costs
- Review of Sector Information (CCH Business Focus)
- Loss of key staff
- Payroll records
- Downturn in sector performance
- Review of Sector Trends (CCH Business Focus)

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**OTHER ISSUES**

**Tax & NI – In the Claim we have assumed a rate of 30%**

- However consider Marginal Rates for other claims i.e. in 2004-05

Earnings (£)	Tax Rate	NI Rate	Total Rate
0 – 4,745	0%	0%	0%
4,746 – 6,765	10%	8%	18%
6,766 – 31,720	22%	8%	30%
31,721 – 36,145	22%	1%	23%
36,146 and above	40%	1%	41%

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**OTHER ISSUES**

**Tax & NI – In the Claim we have assumed a rate of 30%**

- Compare with the rates and bands in 2012-13 (Note Tax rate since 2008-09 and NI rate since 2011-12)

Earnings (£)	Tax Rate	NI Rate	Total Rate
0 – 7,605	0%	0%	0%
7,606 – 8,105	0%	9%	9%
8,106 – 42,475	20%	9%	29%
42,476 – 150,000	40%	2%	42%
150,101 and above	50%	2%	52%

- Alternatively, use Facts & Figures for netting down (Sheet 4)

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### STANDARD INFORMATION REQUIRED

- Annual accounts - preferably for 5 years prior to the accident and all years since
- Tax returns (Self Assessment Returns) for above periods
- Monthly sales summary for at least three years prior to the accident and all years since
- Evidence of additional expenses incurred
- Evidence of specific lost contracts, giving values and time frames
- Comparative earnings figures

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### LOSS OF EARNINGS TO THE SELF EMPLOYED

#### Areas we have covered today:

- Understanding & interpretation of Accounts
- Approach to SE Loss of Earnings Calculations
  - With minimal information
  - Following receipt of further information
- External Factors & Other issues
- Information Gathering

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## QUESTIONS ?

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*Disclaimer*

*This seminar is of a general nature and is not a substitute for professional advice.*

*No responsibility can be accepted for the consequences of any action taken or refrained from as a result of what is said.*

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**LOSS OF EARNINGS TO THE SELF-EMPLOYED  
BACKGROUND TO CASE STUDY - PART 1**

**SHEET 1**

Year ended	31-Mar-01	31-Mar-02	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06
	£	£	£	£	£	£
	<b>PRE - ACCIDENT YEARS</b>				<b>YEAR OF</b>	<b>POST</b>
<b>Profit &amp; Loss Account</b>					<b>ACCIDENT</b>	<b>ACCIDENT</b>
Turnover	47,500	48,000	47,950	48,100	26,000	52,500
Expenses	17,757	17,532	27,832	18,433	19,105	20,571
<b>Net Profit</b>	<b>29,743</b>	<b>30,468</b>	<b>20,118</b>	<b>29,667</b>	<b>6,895</b>	<b>31,929</b>

Drawings	23,000	22,000	22,000	23,000	20,000	23,000
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Self-Employed Roofer (Sole trader):

Accident Date	1-Jun-04
Return to work at 50% capacity	1-Dec-04
Return to working at full capacity	1-Apr-05

**Estimate 'ball-park' loss - assume Tax & National Insurance at 30%**

**LOSS OF EARNINGS TO THE SELF-EMPLOYED  
BACKGROUND TO CASE STUDY - PART 2**

SHEET 2.1

Year ended	31-Mar-01	31-Mar-02	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06
	£	£	£	£	£	£
	<b>PRE - ACCIDENT YEARS</b>				<b>YEAR OF</b>	<b>POST</b>
<b><u>Profit &amp; Loss Account</u></b>					<b>ACCIDENT</b>	<b>ACCIDENT</b>
Turnover	47,500	48,000	47,950	48,100	26,000	52,500
Cost of Sales	9,500	9,120	19,180	9,620	9,200	10,500
Gross Profit	<u>38,000</u>	<u>38,880</u>	<u>28,770</u>	<u>38,480</u>	<u>16,800</u>	<u>42,000</u>
Gross Profit Margin	80%	81%	60%	80%	65%	80%
Overheads:						
Wages	2,980	3,060	3,180	3,500	3,500	3,750
Insurance	277	287	287	298	305	321
Telephone	450	475	485	495	500	510
Motor expenses	2,100	2,250	2,350	2,400	1,200	2,500
Accountancy	500	550	600	650	1,000	750
Bank charges and interest	250	265	275	285	350	290
Miscellaneous expenses	50	75	75	35	1,200	550
Depreciation	1,650	1,450	1,400	1,150	1,850	1,400
	<u>8,257</u>	<u>8,412</u>	<u>8,652</u>	<u>8,813</u>	<u>9,905</u>	<u>10,071</u>
Net Profit	<u>29,743</u>	<u>30,468</u>	<u>20,118</u>	<u>29,667</u>	<u>6,895</u>	<u>31,929</u>

Self-Employed Roofer (Sole trader):

Accident Date	1-Jun-04
Return to work at 50% capacity	1-Dec-04
Return to working at full capacity	1-Apr-05

1. Review line by line to generate appropriate questions for the Claimant
2. Re-calculate loss using information provided by Claimant - assume Tax and National Insurance at 30%

**LOSS OF EARNINGS TO THE SELF-EMPLOYED  
CASE STUDY - PART 2  
SALES DAY BOOK**

Year ended	31-Mar-02	31-Mar-03	31-Mar-04	31-Mar-05	31-Mar-06
	£	£	£	£	£
	<b>PRE - ACCIDENT YEARS</b>			<b>YEAR OF ACCIDENT</b>	<b>POST ACCIDENT</b>
Month:					
April	5,300	5,400	5,600	6,150	6,200
May	5,500	5,600	5,800	6,250	6,350
June	5,750	5,775	5,700	0	6,150
July	5,950	6,000	5,850	0	6,100
August	5,900	5,850	5,700	0	6,100
September	3,500	2,500	2,950	0	4,500
October	0	1,150	500	0	350
November	2,750	2,600	2,850	0	3,000
December	1,900	1,950	1,900	1,950	2,000
January	2,625	2,600	2,550	2,750	2,800
February	3,450	3,350	3,400	3,500	3,550
March	5,375	5,175	5,300	5,400	5,400
<b>Total Turnover</b>	<b>48,000</b>	<b>47,950</b>	<b>48,100</b>	<b>26,000</b>	<b>52,500</b>
<b>Turnover per P&amp;L accounts</b>	<b>48,000</b>	<b>47,950</b>	<b>48,100</b>	<b>26,000</b>	<b>52,500</b>
	(Sheet 2.1)				

*Accident Date - 1 June 2004*

LOSS OF EARNINGS TO THE SELF-EMPLOYED  
CASE STUDY PART 2  
PRO-FORMA FOR ANSWER

SHEET 2.3

£

**Turnover:**

Loss of Turnover + 26,166

**Cost of Sales:**

Additional Subcontractor Costs + 4,000

Saving in Material Costs - 5,233

Loss of Gross Profit 24,933

**Expenses:**

Additional Expenses Incurred + 1100

Saving in Expenses - 1200

Loss of Net Profit 24,833

Less Tax & NI 30% 7,449.90

**Loss of Net Earnings** 17,383.10

**LOSS OF EARNINGS TO THE SELF-EMPLOYED  
CASE STUDY - PART 2  
CLAIMANT RESPONSES AND EFFECT ON ANSWER**

SHEET 3.1

**1 Turnover**

Mr Eriksson has told us that:

- a his turnover would have increased in 2004/05, but for the accident, as he had increased his daily rate from £225 to £250 in April 2004
- b in the 6 months immediately after the accident he generated no turnover
- c in the following 4 months, Mr Eriksson incurred no loss of turnover as he employed his friend to assist him with the heavy manual work that he could not undertake due to the accident

Mr Eriksson's total turnover from June to November in each year was as follows:

	£	
2001/02	23,850	
2002/03	23,875	
2003/04	23,550	
2004/05		← Absent from work
2005/06	26,200	

The actual turnover in 2006 shows that Mr Eriksson has been able to pass on his rate increase to his customers i.e.  $£26,200 \times 225/250 = £23,580$  - similar to the levels achieved from June to November between 2001 and 2003 This is also supported by the increase achieved in April and May 2005 (see sheet 3.3)

**Therefore Estimated Loss of Turnover =  $£23,550 \times 250/225 = £26,167$**   
**(see £26,200 achieved in 2006 as credibility)**

**2 Cost of Sales**

Mr Eriksson has told us that:

- a he has never previously employed sub-contractors, apart from in 2002-03 when he injured his back. The total subcontractor costs incurred in that year were £10,000.
- b this year he asked his friend (who was previously unemployed) to assist him with the heavy manual work between 1 December 2004 and 31 March 2005 and paid him £4,000 in total (£50 per day)
- c he used the same supplier of materials during this period and there were no significant increases in prices i.e. he was still achieving a gross profit margin of approximately 80% on materials

Mr Eriksson's evidence, outlined above, is supported by reviewing his cash book i.e. the cash books showed no previous costs in relation to sub-contractors, other than in 2002-03 and the £4,000 being incurred between December 2004 and March 2005.

**Additional Sub-contractor Costs incurred between December 2004 and March 2005 = £4,000**

**Saving in Materials Costs between June and November 2004 =  $£26,167 \times 20\% = £5,233$**

### 3 Overheads

On reviewing the expenses incurred in 2004/05 compared with previous years, the only items that appear unusually different are:

a Motor Expenses

Mr Eriksson did not have to travel to work in the 6 months from June to November 2004

This is supported by his motor expenses being 50% of the level incurred in 2003/04

**Therefore Saving in Motor Expenses = £1,200**

b Accountancy

Mr Eriksson asked his accountants to prepare some draft calculations of what his loss could be.

Additional cost of performing this exercise was £300 - **not to be included in the claim**

c Miscellaneous Expenses

included in Miscellaneous expenses are costs of approximately £1,100 relating to a bonus paid to his administrative assistant during his absence from work.

These costs were incurred by Mr Eriksson in trying to maintain his business contacts.

**Therefore, additional Miscellaneous expenses incurred = £1,100**

d Depreciation

the increase in Depreciation charge arose as a result of Mr Eriksson purchasing a new vehicle in April 2004 (before the accident).

**The increase in Depreciation was therefore not caused by the accident**

**LOSS OF EARNINGS TO THE SELF-EMPLOYED  
CASE STUDY - PART 2  
CREDIBILITY CHECK ON MODEL ANSWER**

Year ended	31-Mar-05 <b>ACTUAL</b> £	31-Mar-05 <b>LOSS</b> £	31-Mar-05 <b>POTENTIAL</b> £	
Turnover	<u>26,000</u>	<u>26,167</u>	<u>52,167</u>	Higher than in previous years due to rate increase, however still less than in 2005/06
Cost of sales:				
Sub-contractor costs	4,000	(4,000)		
Materials	<u>5,200</u>	<u>5,233</u>	<u>10,433</u>	
Total	<u>9,200</u>	<u>1,233</u>	<u>10,433</u>	
<b>Gross Profit</b>	<u>16,800</u>	<u>24,934</u>	<u>41,734</u>	
<b>Gross Profit Margin</b>	65%		80%	Same as in most other years
Overheads				
Wages	3,500		3,500	
Insurance	305		305	
Telephone	500		500	
Motor expenses	1,200	1,200	2,400	
Accountancy	1,000		1,000	Higher costs not caused by the accident
Bank charges and interest	350		350	
Miscellaneous expenses	1,200	(1,100)	100	
Depreciation	1,850		1,850	
	<u>9,905</u>	<u>100</u>	<u>10,005</u>	
<b>Net Profit</b>	<u>6,895</u>	<u>24,834</u>	<u>31,729</u>	Higher than in previous years due to rate increase, however still less than in 2005/06
Less Tax & National Insurance	30%	(7,450)		
<b>Loss of Net Earnings</b>		<u>17,384</u> *		

\* = Compared with loss estimated based on very little information, of either £14,423 or £15,941

G1: Net equivalents to a range of gross annual income figures

Gross income £pa	2011/12 Employed			Gross income £pa	2011/12 Self-employed			Reason
	Net equivalent income	Net per £100 extra	Reason		Net equivalent income	Net per £100 extra	Reason	
	£pa	£pa			£pa	£pa		
1,000	1,000	100		1,000	1,000	100		
2,000	2,000	100		2,000	2,000	100		
3,000	3,000	100		3,000	3,000	100		
4,000	4,000	100		4,000	4,000	100		
5,000	5,000	100		5,315	5,315	Note 2		
6,000	6,000	100		6,000	5,870	Note 2	← £130 NIC Class 2 payable	
7,000	7,000	100		7,000	6,870	Note 2		
7,225	7,225	88	← 12% NIC Class 1 payable	7,225	7,095	91	← 9% NIC Class 4 payable	
7,475	7,445	68	← 20% tax payable	7,475	7,322	71	← 20% tax payable	
8,000	7,802	68		8,000	7,695	71		
9,000	8,482	68		9,000	8,405	71	Note 2 £2.50 x 52 weeks = £130 pa fixed for any	
10,000	9,162	68		10,000	9,115	71	level of income in excess of £5,315 pa. So net equivalent of £5,100 gross is £4,970.	
11,000	9,842	68		11,000	9,825	71		
12,000	10,522	68		12,000	10,535	71		
13,000	11,202	68		13,000	11,245	71		
14,000	11,882	68		14,000	11,955	71		
15,000	12,562	68		15,000	12,665	71		
16,000	13,242	68		16,000	13,375	71		
17,000	13,922	68		17,000	14,085	71		
18,000	14,602	68		18,000	14,795	71		
19,000	15,282	68		19,000	15,505	71		
20,000	15,962	68		20,000	16,215	71		
21,000	16,642	68		21,000	16,925	71		
22,000	17,322	68		22,000	17,635	71		
23,000	18,002	68		23,000	18,345	71		
24,000	18,682	68		24,000	19,055	71		
25,000	19,362	68		25,000	19,765	71		
26,000	20,042	68		26,000	20,475	71		
27,000	20,722	68		27,000	21,185	71		
28,000	21,402	68		28,000	21,895	71		
29,000	22,082	68		29,000	22,605	71		
30,000	22,762	68		30,000	23,315	71		
31,000	23,442	68		31,000	24,025	71		
32,000	24,122	68		32,000	24,735	71		
33,000	24,802	68		33,000	25,445	71		
34,000	25,482	68		34,000	26,155	71		
35,000	26,162	68		35,000	26,865	71		
37,500	27,862	68		37,500	28,640	71		
40,000	29,562	68		40,000	30,415	71		
42,475	31,245	58	← NIC Class 1 reduced to 2% and 40% tax payable	42,475	32,172	58	← NIC Class 4 reduced to 2% and 40% tax payable	
45,000	32,709	58		45,000	33,636	58		
50,000	35,609	58		50,000	36,536	58		
55,000	38,509	58		55,000	39,436	58		
60,000	41,409	58		60,000	42,336	58		
65,000	44,309	58		65,000	45,236	58		
70,000	47,209	58		70,000	48,136	58		
75,000	50,109	58		75,000	51,036	58		
80,000	53,009	58		80,000	53,936	58		
85,000	55,909	58		85,000	56,836	58		
90,000	58,809	58		90,000	59,736	58		
95,000	61,709	58		95,000	62,636	58		
100,000	64,609	Note 1		100,000	65,536	58		
150,000	90,619	48	← 50% tax payable	150,000	91,546	48	← 50% tax payable	
200,000	114,619	48	Note 1 Personal allowance reduced to nil between £100,000 and £114,950.	200,000	115,546	48		
250,000	138,619	48		250,000	139,546	48		
300,000	162,619	48		300,000	163,546	48		