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Her Majesty's Revenue and Customs Research Report 431

Making Tax Digital for Businesses

Exploring Small Business and Agent attitudes and engagement with Making Tax Digital

Prepared by Jigsaw Research for Her Majesty's Revenue and Customs

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Research requirement (background to the project)

HMRC is in the process of transforming the administration of the tax system through its Making Tax Digital (MTD) programme. MTD will transform the tax administration so it is more effective, more efficient and easier for taxpayers.

At Autumn Statement 2015¹ the government announced that, by 2020, most businesses, self-employed people and landlords would be required to use digital tools (such as software and apps) to keep track of their tax affairs and update HMRC quarterly, via their digital tax account. The case for doing so was threefold:

- a better experience for the business built on the confidence that they had got their tax right, with the certainty that enabled them to plan their cash flow more effectively;
- a level playing field for businesses, with a significant reduction in the tax gap caused by small business error; and
- a reduction in the administrative burden (post transition) of dealing with HMRC.

While the principles of the changes were announced by the Chancellor at Autumn Statement, HMRC is currently planning a number of detailed consultations throughout 2016 to gather business views, to help develop the Making Tax Digital proposals and inform its final design.

This research aimed to further develop our understanding of business customers' and agents' attitudes and behaviours around tax administration and the Making Tax Digital principles specifically. This understanding has informed the development of those consultations and the wider development of Making Tax Digital.

Aims and Objectives

This qualitative research aimed to develop HMRC's understanding of businesses' perceptions, attitudes, behaviours, motivations and barriers to elements of MTD for Business (MTDfB) design - using digital tools to keep business records, updating HMRC quarterly and voluntary payment closer to real time.

More specifically the project was tasked with gaining an understanding of;

- **Small businesses and agents overall understanding of, and reactions to the requirements of MTDfB** (e.g. use of digital record-keeping tools, updating HMRC quarterly, options to pay more frequently)
- **Current small business practices relevant to the requirements of MTDfB**
- **Perceived impacts of MTDfB proposals** on customer experience and business practice

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/484668/making-tax-digital.pdf

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- **Barriers, levers and tipping points to engaging with MTDfB** - that would influence businesses and agents' ability and/or willingness to take-up and/or engage with the MTDfB propositions
- **Views of, and potential impacts on, agents** and their working relationships with business customers
- **Small businesses' support needs** for migrating to MTD
- **Variations across the business population** by business type, sector and/or current digital capability

When the research took place

The fieldwork for this research took place between 1st February and 11th March 2016.

Who did the work (research agency)

The research was undertaken by Jigsaw Research Ltd. The team for the project comprised Hazel Fletcher, Ann Morgan, Luke Perry and Peter Totman.

Method, Data and Tools used, Sample

The research undertaken was qualitative². The objectives of the research were multi-faceted, therefore a mixed methodological approach was adopted to optimise insight. The research programme was as follows:

² Please note that because this research is qualitative its results should be treated as indicative rather than statistically definitive.

STAGE ONE	<ul style="list-style-type: none">▪ 16 x 1.5-2 hour in-depth interviews▪ 9 x 1.5 hour group discussions▪ 12 x Agent depths
TOPLINE RESULTS FROM STAGE 1	<ul style="list-style-type: none">▪ Results from stage 1 used to determine the key areas of focus for co-creation workshops▪ Content and structure of sessions driven by emerging issues
STAGE TWO	<ul style="list-style-type: none">▪ 4 x 2.5 hour co-creational workshops with businesses reconvened from Stage 1 so already familiar with MTD principles
MATERIALS	<ul style="list-style-type: none">▪ Stimuli used to provide greater context of potential options in relation to software, updating and payments to inform discussions
SAMPLE	<ul style="list-style-type: none">▪ Range of business types (SA, Micro, Small)▪ Range of sectors (e.g. Construction, Accommodation)▪ Range of digital capability▪ Range of representation▪ Range of locations (Bristol, Glasgow, London, Manchester)

Stage 1 – research to understand barriers, levers and impacts of MTDfB

Ethnographic style depths with businesses carried out at their place of business.

- To understand how the requirements of MTDfB would sit alongside existing business practices; where the synergies and the conflicts lie

Mini-groups with businesses.

- To understand the range of likely responses to MTDfB, elicit the motivations and barriers to voluntary uptake, to inform the HMRC narrative and communications around MTDfB.

Depths with agents

- To understand the perceived implications for agents

Stage 2 - Co-creational workshops

- Building on the key issues identified in Stage 1 and involving businesses reconvened from Stage 1 and HMRC policy and customer strategy officials. The sessions were used to develop approaches to implementing MTDfB, overcome barriers and generate levers to positively influence take-up of MTDfB.

A careful sample design was required to ensure that the full range of relevant audiences was included. This involved ensuring a range of customers by:

- **Business type** (covering a spectrum from customers who pay the majority of their tax through PAYE but who also have secondary self-assessed income for £10,000 or more per annum, though to small businesses with turnover up to £10m per annum and up to 20 staff)
- **Sector**. Nine sectors were included. These were selected by HMRC to be those likely to be harder to engage with MTD, e.g. due to lower digital capability, seasonal/fluctuating income or fluctuating cash flow.

- **Tax capability, digital capability and business life stage.**

We also included a sub-sample of Agents as they are a critical audience in terms of helping certain customer types to meet their tax obligations.

The interview sample was recruited in line with the following sample design

*PAYE/SA	SOLE TRADERS	MICRO & SMALL BUSINESSES	AGENTS
<ul style="list-style-type: none"> ▪ 1 x Mini-group ▪ 2 x Ethno-depths <p>SA INCOME THRESHOLD</p> <ul style="list-style-type: none"> ▪ All to have secondary self assessed income of £10,000 or more <p>*This is shortcut used to describe this type of business throughout the rest of the report</p>	<ul style="list-style-type: none"> ▪ 4 x Mini-groups ▪ 6 x Ethno-depths ▪ 2 x Co-creation workshops <p>SECTORS</p> <ul style="list-style-type: none"> ▪ Education / Arts, Ents & Recreation ▪ Health & Social Work ▪ Wholesale & Retail ▪ Construction ▪ Transport & Storage 	<ul style="list-style-type: none"> ▪ 4 x Mini-groups ▪ 6 x Ethno-depths ▪ 2 x Co-creation workshops <p>SECTORS</p> <ul style="list-style-type: none"> ▪ Accommodation & Food Services ▪ Agriculture, Forestry & Fishing ▪ Manufacturing ▪ Wholesale & Retail ▪ Construction 	<ul style="list-style-type: none"> ▪ 12 f2f depths <ul style="list-style-type: none"> ▪ 4 x 1 man bands ▪ 4 x 1-2 partners in firm ▪ 4 x 3-5 partners in firm
<p>Research conducted across 4 locations; Glasgow, London, Bristol and Manchester</p>			

In **Stage 1** we used a set of stimulus materials designed to explain the proposals to participants and generate discussion and reactions to those proposals. The stimulus materials were designed to cover each of the main elements of MTDfB (digital record keeping, quarterly updating HMRC and more frequent payment on a voluntary basis) and the different options under discussion within each.

In **Stage 2** we introduced the sessions by presenting back to participants the key findings from Stage 1 (perceived benefits and concerns in reactions to MTDfB) and used these as a starting point for brainstorming ways (from both a policy and an implementation and/or communication perspective) that concerns could be overcome, as well as positive ideas for implementation and communication.

Main Findings

The main research findings are outlined below.

It should be noted that where words such as majority, minority, some, many etc. are used in the report, this relates to the businesses participating in the research and may not reflect the views of the business population as a whole.

Attitudes to Making Tax Digital; Overall acceptability of the proposals

Overall resistance to MTDfB is limited; businesses expect to comply with requirements given that this is a Government initiative underpinned by the perceived threat of HMRC sanctions.

Businesses do find the vision of a transformed 'real time' tax system appealing; the principles of a tax system where it is easier to meet tax obligations and customers have more certainty around their tax liability do resonate.

However, MTDfB is not an 'easy sell'; the majority of businesses do not welcome what initially appears to be an increase in their tax related obligations and the disadvantages of MTDfB are more immediately apparent than the potential benefits. That said, the range of potential benefits as identified by businesses when discussing the MTD proposals does offer the possibility of creating positive engagement with MTDfB and many businesses, given space and time to consider it, do see some potential benefits.

The quality and design of MTDfB software/app is critical to acceptance. The design of the software/app has the potential to make or break the success of MTDfB, such that it could function as a key enabler or a major barrier. Designed well the software/app has the power to be transformational - delivering control, greater certainty, greater autonomy and greater confidence. And the more advanced features could shift the software/app away from being simply a tool to help meet tax obligations towards a business management tool.

Customer reactions to the main elements of the MTDfB proposition are as follows:

Digital record keeping

The first area explored with businesses within the research was the MTDfB requirement for them to maintain their records digitally using third party software. Many small businesses were keeping records electronically already, so for them digital record keeping was essentially business as usual. Some PAYE/SA customers welcomed the idea of digital record keeping in principle as they believed it would help them to become more organised and systematic about their record keeping. Many, however, saw digital record keeping as an unnecessary burden. They could see the benefits that digital record keeping would bring to larger businesses with more complex tax affairs but for many of them it seemed like an inappropriate burden. Sole traders and Micro businesses were also somewhat divided in their attitudes to digital record keeping. Some welcomed the idea on the basis that it would encourage discipline and a more systematic approach. Others were already well organised, have developed their own record keeping system and were reluctant to change it. The most

common reaction was a somewhat resentful level of resignation based on the perception that if digital record keeping is mandated they will comply, even if it requires an unwelcome change in their current practices.

Quarterly updates and a tax estimate in year

The research next explored businesses' views on the MTDfB requirement to update HMRC on a quarterly basis from their digital records. This element of the MTDfB proposition generated the most debate and questions as it represents a significant and new shift in their tax obligations. Initially customers focused on the perceived extra burden involved here and were not always able to see any real customer benefit that would accrue. Many businesses have already developed their own methods of estimating their tax liability on an ongoing basis, enabling them to manage cash flow and plan ahead. For them the potential benefit of having an in year tax estimate was not particularly appealing – it requires extra work on their part (the quarterly update) with no perceived additional reward. However, others (most commonly sole traders and SA/PAYE customers) welcomed the idea that quarterly updates would give them greater certainty during the year about their tax liability year to date.

VAT registered businesses were unanimous in their desire to have VAT reporting dates and the new quarterly updating dates aligned. Whilst, those businesses for whom tax reliefs, credits and allowances are part of their annual tax process were united in believing that these should continue to be dealt with at the end of the tax year. They found it difficult to imagine how these could be built in to the quarterly updates.

Paying more frequently

The final element of MTD proposals explored within the research was the opportunity MTD provides for businesses to pay tax more frequently, in closer to real time and on a voluntary basis. Most businesses (SME, sole trader and PAYE/SA) were unwilling to pay their tax bill any sooner than is absolutely necessary and as a result most wished to continue to pay tax as they do now – once per year after the end of their financial year. However, a minority felt they may choose to pay more frequently if this were offered on a voluntary basis as it would remove the need to make provision for the entire tax bill during the year. Even they, however, wanted to be able to stop, reduce or defer payments if they needed to.

Overall, agent views were balanced. On the one hand, they saw real potential benefits in MTDfB for their clients (particularly in relation to improved record keeping and improved understanding of their ongoing tax situation) and for themselves (in improving the quality of records they receive, reducing the amount of manual data entry they need to do and allowing full access to the Digital Tax Account). On the other hand they expected their workload to increase, they had concerns about the year-end process, the ability of some of their clients to manage quarterly digital updates and their ability to pass on increased costs to clients where the agent's workload has increased.

Attitudes to Making Tax Digital; Benefits

One of the key objectives for this research was to understand what potential benefits MTD offers that could motivate business to engage with MTD.

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Some clear benefits emerged spontaneously from the research as businesses considered the proposals, which could be leveraged to create positive engagement with MTD. These relate to discipline, control, confidence and certainty. The smallest businesses (e.g. sole trader and micro businesses) felt that MTD offered potential 'practical' and 'emotional' benefits, for example greater control, more autonomy, reduced stress by spreading the load across the year. Wider benefits could be seen by those at the larger end of the small business population; for example, the potential for tailored advice and support and a reduction in tax evasion.

Specifically businesses could see the following potential benefits:

- For some the discipline of the quarterly updating deadline would drive them to better record keeping practices and this could help them feel more in control of their businesses.
- Some could see that having all of their records in one place would be easier and more convenient than their current systems where different items are stored in different ways/places
- Some predicted that MTD would give them greater certainty over their business position and so enable them to make better business decisions on expenditure/investment.
- Some predicted that MTD would give them greater certainty around their likely tax bill which in turn would enable them to make better provision to pay.
- Some felt that MTD could give them increased confidence in themselves as business owners by making the financial side of running their business more accessible and transparent.
- Some felt that the emotional and practical burden of the end of year tax return could be reduced by spreading the load across the year.
- Some felt that MTD could potentially reduce their reliance – emotional and practical - on accountancy services.
- The prospect of tailored advice and support was motivating for some, especially if this was around reliefs and allowances that might reduce the business's overall tax bill.
- Some felt that MTDfB represented a fairer tax system as it meant the end of paying tax on account for those in SA.
- And (for some) the opportunity to pay tax more frequently and so reduce the burden of the end of year tax bill was welcome.

Agents saw that MTD could improve their clients' approach to tax. Specifically:

- The requirement to keep digital records may improve overall record keeping.
- It would also impose greater discipline in keeping relevant information up to date and in order.
- Clients would have a better understanding of their ongoing tax position and be better able to plan and budget for tax payment.
- Some clients would benefit from potentially being able to spread payment of tax into more manageable chunks across the year.
- Some also felt it would enable them to focus more on added value advice and services, rather than commodity services around record keeping and data entry.

Attitudes to Making Tax Digital; Concerns

This research was undertaken ahead of the planned consultations which will contain further information on the potential detail of the MTD proposals. At the time the research was undertaken, businesses were therefore able to raise a range of concerns in the absence of further design on the detail of how MTD would work. The key concerns expressed by businesses are as follows.

Moving away from existing record keeping practices is unwelcome for many. A range of concerns were raised, particularly amongst the smallest (e.g. sole traders, micro):

- Current systems have been developed over time to fit the needs of the business. There is a natural reluctance to move away from these systems.
- Some anticipated maintaining old systems alongside adopting the new digital records, so perceive and unwelcome duplication of effort.
- Businesses were apprehensive about using a new/untried method.
- Fear of increased transparency was an issue for some, where digital record keeping was seen to be at odds with their current less formal practices (particularly those within the Construction sector).

Adopting the new software can also cause concern:

- Something which would feel fine in another context felt stressful and pressurising when tax/HMRC are involved. This is partly due to lack of sophisticated tax knowledge and partly due to fear of making a mistake.
- The digitally least confident were most apprehensive about this; it's out of their comfort zone and they don't want to get it wrong; there were varying attitudes from reluctant resignation to welcoming the push.

The prospect of quarterly updates feels pressurising for many businesses:

- The practical and emotional burden of 4 tax deadlines a year.
- The fear of perceived penalties associated with missing a deadline and/or supplying HMRC with an update that is 'wrong' in some way.
- The shift away from tax as something to be worried about annually to something that could feel like a constant pressure.

The prospect of paying tax more frequently was strongly resisted by many businesses; the majority are unwilling to pay their tax bill any sooner than necessary for a multitude of reasons. Although MTD proposals are for more frequent payment only to be enabled on a voluntary basis, there was particular resistance if this was mandated or inflexible, as it would remove access to their finances when needed.

Agents had a separate set of concerns, based on their knowledge of their client base. They were concerned that:

- Clients will enter inaccurate information unless it is checked by an agent.
- Some clients will not be able to cope with digital record keeping at all. They will still pass a set of paper records to their agent and rely on the agent to fulfil the digital record keeping obligation.

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- MTDfB introduces more deadlines into the tax cycle and some clients will be liable to miss these.
- The process for handling year end issues (reconciliation, reliefs, allowances, credits etc.) is not clear and may be problematic and will increase their work load.
- While the promise of full access to their clients' Digital Tax account was motivating for some, others were sceptical as they currently had frustrations with the limited access they currently have.
- MTDfB would force them to increase their role as 'disciplinarian' vis a vis their clients
- Overall MTDfB will constitute more work for agents and they may not be able to pass on the additional costs to clients.

Attitudes to Making Tax Digital; Factors influencing Engagement

Based on the diverse views expressed by businesses in exploring the MTDfB proposals, a small number of factors emerged as being key influencers of their potential engagement with MTDfB. These were:

Size and type of business

Responses to MTDfB were highly dependent on the size and type of business. Sole Traders and Micro businesses felt they would be most impacted by MTDfB and would also have the most potential to benefit practically and emotionally. Small and PAYE/SA businesses will be impacted less overall.

The shift away from current record keeping practices is greatest at the smaller end of the business spectrum (PAYE/SA, Sole Trader and Micro businesses) where paper based record keeping is still very common and the use of accounting software is relatively low. However, these businesses did not have a problem with digital record keeping per se. Even the less digitally confident, while slightly more anxious about the move, largely accepted it on the assumption that the software will be easy to use and support will be available to help them with the transition. For small businesses where use of accounting software packages is the norm, digital record keeping is business as usual.

PAYE/SA businesses could feel that MTDfB is a bit 'over engineered' for their circumstances. They see themselves as 'self-employed people', not 'businesses' so MTDfB can seem over the top for their simple businesses and they did not welcome the thought of engaging with tax more than is absolutely necessary.

Sole Traders and Micro businesses is a key audience for MTDfB. They are the audience for whom MTDfB represents the biggest shift from their current practices. They were the most likely to see immediate and motivating benefits in the proposed changes, but they also tended to have the most concerns and questions. It will be critical for this group that MTDfB implementation is effective, that communications are persuasive and reassuring and that high quality support and guidance is in place.

For small businesses, assuming they can simply update their existing software to a version that accommodates the new requirements, MTDfB represents a small amount of extra work each quarter which, while not welcome, will be absorbed if required.

Industry Sector

Industry sector also plays a role although this is far less pivotal than size and type of company:

Sectors where fluctuating cash flow is a persistent feature were less likely to perceive the potential benefits of MTD (e.g. Construction, Manufacturing, Agriculture, Forestry & Farming, Arts and Entertainment, Accommodation and Food Services).

For these businesses, the quarterly updates are likely to be of less value as they are likely to be highly skewed/atypical depending on the specifics of income and expenditure in that quarter. They also worried that presenting HMRC with a fluctuating position quarter on quarter will somehow lead to question marks over the accuracy of their updates and potential repercussions. Finally they questioned how the software will cope with an erratic quarterly picture. Will it highlight 'errors' falsely or miss true errors?

In addition, sectors where a mix of declared and undeclared income was suggested by businesses as common did not welcome the increased transparency implicit in MTDfB. Businesses in some sectors are used to a system where they engage with tax at year end to produce acceptable figures for HMRC (often with the help of an Agent).

Digital confidence

Levels of digital confidence will also impact engagement. Those at the lower end of digital confidence as measured in terms of their current record keeping practices are likely to require greater levels of support and reassurance as they begin to implement MTDfB within their business. This was more commonly the case in the smaller businesses (PAYE/SA, Sole Trader and Micro businesses).

In enabling and ensuring positive engagement with the MTDfB proposals, all businesses felt that the design of support, communications and the software would be crucial in ensuring businesses are reassured, enabled and transitioned to MTDfB easily.

Software design

The design of the software/app is central. The software needs to be accessible and easy to use, providing a range of options to suit the different sizes and types of businesses, in particular for those businesses with lesser digital confidence. Businesses will need reassurance that it is accurate, reliable and secure.

Communications

The content, tone and timing of communications around MTDfB will be vital in encouraging positive engagement with the new regime. Ideally, the communication programme would be tailored towards different business types/sizes and would launch well in advance to give businesses time to prepare for the changes. The research has identified several potential benefits of MTDfB, the communication of which may encourage positive engagement, although it would also be important to acknowledge some of perceived downsides and also the mandatory nature of the changes.

Support and Guidance

Similarly the provision of good guidance and support will be vital in encouraging positive engagement with MTDfB and there is an appetite for a wide range of online support. YouTube 'demo videos', online tutorials, 'how to' guidance and FAQs, web chat, screen sharing, software user groups were all suggested by businesses as forms of support that would be welcomed. The less digitally confident want to be able to access help by phone or even the opportunity to attend MTDfB workshops/seminars

Conclusions

Businesses accept that they will comply with the mandatory requirements of MTDfB, however some will comply more willingly and competently than others. Many businesses recognise this as an inevitable and progressive move towards a more modern tax system and will make the changes necessary to comply without huge enthusiasm but equally without resentment.

But for some, most notably PAYE/SA businesses, businesses in some sectors and businesses with fluctuating cash flow - the barriers to engagement dominate and they struggle to see the benefits to them of MTDfB; these businesses will comply but with reluctance and some resentment.

Finally, some businesses quickly recognise the benefits MTDfB might give to them and their business and so are keen to adopt MTDfB. Enthusiasm is strongest amongst the less organised and/or less confident sole trader and micro businesses across all sectors.

The range of potential benefits does offer the possibility of creating positive engagement with MTDfB. The challenge is to leverage the benefits and persuade businesses that the initial effort of engaging with MTDfB will reap rewards in the longer term.

Successful business engagement will be encouraged by:

- The design of the digital record keeping software/app,
- The quality of the communications programme and narrative,
- The effectiveness of the guidance and support offered to businesses
- A well planned and executed launch