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# Understanding evasion by Small and Mid-Sized Businesses

HM Revenue and Customs Research Report 433



HM Revenue  
& Customs

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## Glossary of terms

The table below provides a list of terms used in this report:

<b>Agent</b>	A person or organisation acting on behalf of a business or individual providing professional tax advice or guidance e.g. an Accountant or Independent Financial Advisor
<b>Mass Media</b>	The collection of traditional media outlets e.g. television, newspapers, radio that reach a large audience
<b>Media Noise</b>	The associated dialogue and attention created by stories covered by the media that impact upon the discussion of a topic
<b>Mid-Sized Business</b>	Businesses which are defined as having either 20 employees or more and/ or a turnover of more than £10 million but less £200 million
<b>Small Business</b>	Businesses which are defined as having a turnover of up to £10m, <i>and</i> fewer than 20 employees
<b>Social Media</b>	Computer mediated tools which facilitate the online interaction of people and/or businesses through social networking via the internet
<b>Societal/ Sectoral norms</b>	The rules or conventions which are considered acceptable behaviour within a particular society, group or sector of the economy

## 1. Summary

### 1.1 Research aims

HM Revenue and Customs commissioned Quadrangle to conduct qualitative research to inform their understanding of tax evasion amongst Small and Mid-Sized Businesses.

Specifically, this research was required to:

- Provide insight on the characteristics and attitudes of Small and Mid-Sized Businesses that engage in tax evasion, and how these link with actual behaviours
- Evaluate the likely impact of different approaches to prevent evasion, promote compliance, or respond to incidents of evasion, and inform understanding of what approaches would be most effective in changing behaviour.

### 1.2 Methodology

Forty-five semi-structured depth interviews (a mix of telephone and face-to-face) were conducted with Small and Mid-sized Businesses from a broad range of sectors, all were recruited on the basis that they were engaging (or had previously engaged) in tax evasion behaviours, and critically that these behaviours were deliberate rather than accidental.

### 1.3 Key findings

- Five core attitudinal variables appear to differentiate between types of businesses in terms of their engagement with (and drivers of) evasion behaviours;
  - i. Sense of citizenship: an individual's core values and beliefs which are the foundation for evasion behaviour
  - ii. Distinction between personal and business assets: the extent to which business affairs and assets are kept separate from an individual's own (or family) affairs and assets
  - iii. Perceived risk: both in terms of the risk itself, and the business' ability to manage or mitigate risks
  - iv. Perceived financial imperative or reward: the focus (i.e. business or personal) and strength of any financial drivers of evasion behaviours
  - v. Willingness to seek out or create opportunities to evade: the degree of strategic planning involved in evasion activity
- The five attitudinal variables summarised above interact with external influences – namely, social norms, media noise, market pressures and agent use – to determine four core types of evader;
  - i. Unthinking evaders, for whom low level evasion is habitual, and often adopted without thought
  - ii. Invested evaders, for whom evasion is seen as an unfortunate financial necessity in order to stay in business (where the end justifies the means)
  - iii. Lifestyle evaders, for whom evasion enables a life-style otherwise out of reach, which they feel is justified by the taxes they do pay

- iv. Systematic evaders, where evasion is actively considered and integral to the business model
  - Across the four core types of evader, behaviours range from relatively infrequent, low value evasion (e.g. circumstantial use of business stock for personal benefit), to considered and systemic evasion (e.g. consistent over-claim of high value expenses, and complex evasion strategies).
  - Some agent use may serve to limit engagement in evasion behaviour, or agents may be unaware of the full extent of evasion taking place (particularly where the agent has been employed primarily to provide peace of mind). However, where agents are used primarily to reduce taxes due, a minority may be complicit in evasion to some extent
  - Believability (or perceived likelihood of being penalised), understanding, and anticipated personal impact are critical to the successful design and implementation of approaches intended to promote compliance and prevent evasion. However, currently, a general lack of believability, understanding and anticipated consequences limit the impact of specific interventions tested.

## 2. Introduction

This document, produced by Quadrangle on behalf of HM Revenue and Customs (HMRC), reports on the findings from qualitative research conducted amongst Small and Mid-Sized Businesses to inform understanding of tax evasion within this audience.

### 2.1 Background and Research context

The majority of businesses and individuals comply with their tax obligations but a minority do not pay the tax they owe. According to 2016 HMRC estimates, evasion contributes £5.2.bn to the tax gap. Reducing tax evasion and thereby reducing the significant revenue loss to the nation's finances is crucial. It is vital that the general public and the business community have confidence in the UK's tax system and believe that those who seek to evade tax will either be prevented from doing so or identified and subsequently penalised and/or prosecuted.

Although evasion is present in all customer groups, Small and Mid-Sized Businesses represent a large portion of HM Revenue and Customs' customer base and account for a significant portion of the tax gap (with Small and Medium Sized Enterprises accounting for c.51% of the total tax gap overall, based on tax gap estimates for 2014-2015<sup>1</sup>) and so are the focal audience for this research.

HMRC's focus is on making voluntary compliance an integral part of their customer services. By harnessing data and intelligence to build compliance into their systems, their aim is to reduce the risk of expensive compliance interventions later on. HMRC's "*Promote, Prevent, Respond*" approach underpins this:

- **Promote** good compliance by designing systems and processes that help customers to get it right first time, supported by effective communications
- **Prevent** non-compliance at or near the time of filing by blocking mistakes and personalising returns
- **Respond** to non-compliance, using data to tailor interventions to the level of risk posed by a customer.

By building a thorough understanding of the characteristics and behavioural drivers behind evasion, it becomes possible to target different interventions at different sub-groups of the Small and Mid-Sized population that evade their tax obligations. Such targeted interventions have the potential to reduce the tax gap, which is the overriding purpose of this work.

### 2.2 Research objectives

This qualitative research aims to identify the characteristics and attitudes of those who engage in evasion, and highlight approaches that would be most effective in changing the behaviour of different types of business. In doing so, it addresses 6 specific research objectives to;

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<sup>1</sup> HM Revenue & Customs (2016) Measuring tax gaps 2016 edition, Tax gap estimates for 2014-2015



- Explore attitudes towards tax evasion amongst Small and Mid-Sized Businesses (including why some evaders do not see themselves as such, while simultaneously engaging in evasion behaviour)
- Explore evasion behaviour amongst Small and Mid-Sized Businesses (i.e. what behaviours does the business actually engage in and how do these relate to the attitudes they have)
- Identify key drivers of evasion by Small and Mid-Sized Businesses (i.e. how do businesses justify their behaviour)
- Explore the role of agents in evasion behaviour (e.g. what relationship does the business have with its external advisors, and who drives decision-making)
- Explore characteristics of the businesses involved in evasion behaviour
- Explore responses to potential HMRC approaches to changing behaviour.

### 3. Sampling and methodology

Qualitative fieldwork was conducted between 21<sup>st</sup> April and 3<sup>rd</sup> May, 2016. Further detail including a full sample breakdown is included in the appendix, but in brief this research entailed:

- Forty five one hour depth interviews with Small and Mid-Sized Businesses, all recruited on the basis that they were engaging in tax evasion, and critically that this evasion behaviour was deliberate rather than accidental
- Respondents were selected on the basis that they were involved in some or all key decisions relating to tax and financial matters within the business
- Mixed interviewing methodology, to suit respondent preferences and allow a greater geographic spread
  - 20 interviews conducted face-to-face
  - 25 interviews conducted over the phone
- A mix of Small and Mid-Sized Businesses
  - 40 Small Businesses
  - 5 Mid-Sized Businesses
- Owing to the challenges associated with recruiting among this hard-to-reach audience, no further quotas were fixed, but size, sector, age of business and region were also monitored to ensure a mix within the sample (see appendices for full sample breakdown).

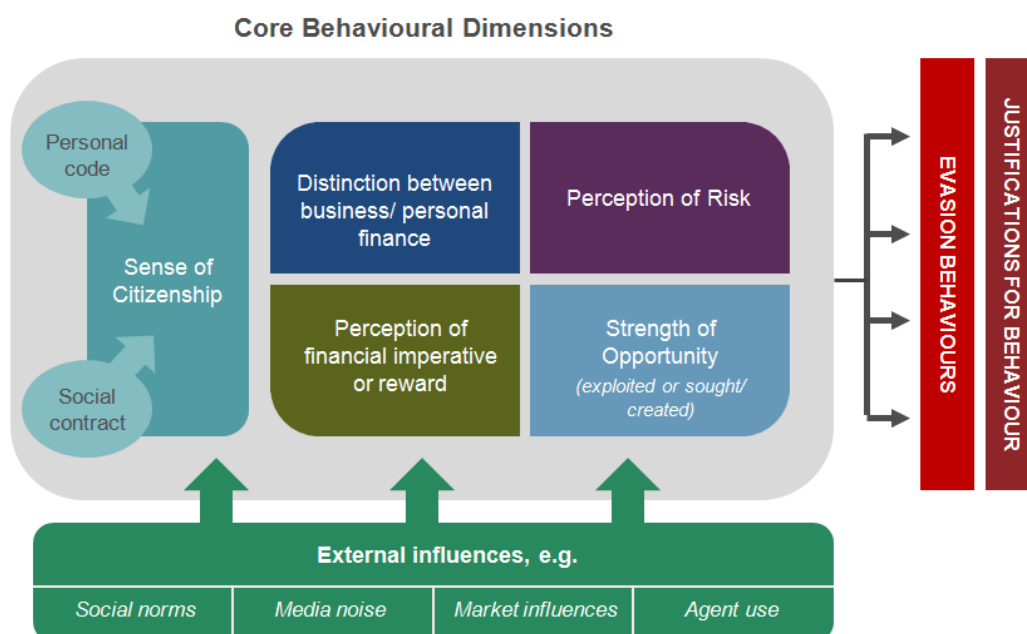
## 4. Main Findings

### 4.1 Understanding Evasion

An array of individual and external variables interact to govern the evasion behaviours, which are ultimately adopted by a business, including:

- **Values, attitudes and perceptions** of those individuals who influence decision making within the business, such as core personality traits, personal or family circumstances, aspirations and ambitions, attitudes towards risk, and approach to financial planning
- **Characteristics of the business itself** (which ultimately determine the extent of the opportunity to evade tax), such as the business model and legal ownership status, main business activities undertaken, tax obligations (types of tax payable), employee profile and resourcing decisions, and business strategy
- **External influences**, such as the role of agents, mass and social media, societal or sectoral norms, market pressures, and changes to regulations or law.

However, by focusing on those attributes and attitudes which really differentiate between the Small and Mid-Sized Businesses interviewed for this research, a model of evasion behaviours can be used to identify distinct types, based on key drivers of evasion and linked to resultant behaviours (see *Figure 1* below).



*Figure 1.*

*The model demonstrates how 5 core dimensions (attitudinal variables which appear to differentiate between types of businesses in terms of the extent to which they are likely to engage in evasion), interact with external influences to determine specific evasion behaviours, and justifications or rationalisations of these behaviours for Small and Mid-Sized Businesses.*

#### 4.1.1 Core Dimension: Sense of Citizenship

Sense of citizenship describes the core values and beliefs which set the foundations for evasion behaviours. It is derived from two main elements: personal code and the social contract, and is fundamental to understanding and explaining the differences in Small and Mid-Sized Business tax evaders.

**Personal Code** refers to the self-image, self-esteem, values and ethics that govern individuals' conduct and behaviour (both personally, and in the context of business decision making). Conscientiousness - the extent to which an individual feels it is important to 'do the right thing', or to be 'a good citizen', is a key component of this dimension. However, it may also be shaped by one's relationship with money (for example, the willingness to spend money which one doesn't have) and/or an individuals' perceived ability or sense of control over their own fate and circumstances. Personal code is typically constant and unchanging, influenced primarily by an individual's upbringing and experience (e.g. role models and education).

**Social Contract** refers to the level of engagement that an individual has with their 'contract with society'. Although the findings of this research indicate that there is a universal acceptance that taxes need to be collected to run society, the emphasis individuals place on either side of the social contract differs, i.e.;

- Focus on individuals' side of the contract (and therefore, the business' side) driven by a strong sense of duty to make a financial contribution to society, and/or deference to authority or the state
- Focus on the state's side of the contract - or the question of 'what does the state actually do for me?'

Level of engagement with the social contract affects an individual's perceptions of how much tax is appropriate for '*me/my business*' to pay and therefore underpins the justifications given to explain evasion behaviours.

In contrast to personal code, which is relatively stable, the 'terms' of the social contract may change, such as in the event of a perceived contract breach by the state (for example, perceived lack of order and justice within the state, perceptions of misspent or unfair distribution of money, or lack of access to services). As such, this may act as a trigger for the adoption of evasion behaviours.

Personal code is typically internalised, and hard to influence, but it may be possible to create and facilitate the conditions in which the social contract can be strengthened. Both work together to influence evasion, and rationalisations for evasion behaviours.

#### 4.1.2 Core Dimension: The distinction between business and personal finance

Evasion was often associated with a blurring of boundaries between what belonged to the business, and what belonged to the individual or their family (in terms of income, finance, time, or goods and stock). Smaller businesses in particular (e.g. lone working owner-managers, or family run businesses) may be more likely to lack clear financial boundaries between their business and their personal or family life. The extent to which business and personal affairs and assets were distinct was found to differ across our sample, impacting on:

- The extent and type of engagement with evasion behaviours, e.g.

- using business stock for personal or family use
- paying for personal or family expenses through ‘the bank of the business’
- The drivers (or rationalisations) of specific evasion behaviours adopted, i.e. the extent to which blurring of boundaries reflects;
  - incidental evasion, with business and personal finances seen ‘as one and the same’; vs.
  - conscious boundary pushing, to take advantage of ambiguity between business and personal finances and enable ‘treats’ otherwise out of reach.

#### 4.1.3 Core Dimension: Perception of financial imperative or reward

Evasion was normally driven by a perceived financial need or reward although the 45 businesses interviewed varied in the extent to which these financial pressures were driven by a real (or imagined) business threat, or by personal reward.

- At its most basic, the stated financial need was the desire to stay in business. In these cases, there was a very real perceived threat that the business would not survive without evasion, and no perceived personal reward for evasion beyond keeping the business afloat
- For others, the financial driver was to grow the business, with evasion deemed necessary to support ambitions or business goals. Although not essential to survival, this growth may be deemed as equally important to the business
- Finally, for some, the financial need was to enable a lifestyle that would otherwise be out of reach. In these cases, evasion behaviours enabled personal reward, often felt to be perks that had been rightfully earned through running the business (which might range from an occasional meal out with family to a holiday abroad, for example)

#### 4.1.4 Core Dimension: Perceptions of Risk

Perceptions of risk reflected not only the actual risks associated with the evasion behaviours themselves, but also the perceived ability of the business to manage or mitigate risk. For most businesses interviewed, evasion would not have been adopted (and continued) if they perceived the behaviour to be risky. Businesses typically deemed the risks to be relatively small, and/or manageable, or offset by the reward, typically citing one or more of the following beliefs and perceptions:

- Evasion behaviours are insignificant either due to their perceived infrequency or low value (and the belief that they are therefore unlikely to be picked up or pursued), so do not pose any real risk
- Evasion behaviour is ‘invisible’ and could never be detected or proven (e.g. cash in hand payments which are not reported as income)
- Risk is calculated and offset by reward (a belief that even if the business were penalised, they would, on the whole, be no worse off financially)
- Risks of penalty can be minimised with careful management, and they would be able to talk themselves out of trouble if investigated (for example, through justification of expenses claimed)

#### 4.1.5 Core Dimension: Strength of Opportunity – either exploited or created

The final attitudinal variable within the model concerns opportunity, and specifically the extent to which businesses would actively seek or create opportunities to evade.

Opportunity is a pre-requisite for evasion, and seems to be rooted primarily in the business attributes and characteristics, for example:

- **Customer base** - businesses with any instance of cash paying customers (typically consumer rather than business) have more opportunity to under-declare income than those where billing or transactional platforms create a paper trail

*“I’ve got an engineer who works in-house all the time, and if he goes out and does – say he goes to Mrs Smith’s and she says, ‘Can I pay in cash, love?’ he’s going to say ‘Yes that’s fine,’ [and we won’t put that through the books]”.* (Small Business, Communications)

- **Employee profile** - creates further opportunities to under report income and/or over claim on business costs, particularly in businesses where family members play a role (or arguably could do);

*“My daughter, she lives in Australia now, but when she was doing her A-Levels, she wasn’t working, so we put her down as though she was, like, doing a little bit of work for us. So we got offset income because she had a tax allowance then.”* (Small Business, Distribution)

or where the business frequently uses casual workers;

*“The two part-timers, I just pay them cash-in-hand but the rest go through the [payroll / PAYE] system”* (Small Business, Business Services)

- **Main business activity** - in businesses where travel and entertainment is more easily justified, by the business activity or customer base, there is more opportunity for businesses to over-claim on expenses

*“It would be easy for me to say, ‘I needed to buy this guitar purely for business use’ and I could list a thousand reasons why I needed it....Although really it’s mostly for personal use.”* (Small Business, Entertainment)

However, opportunity can also be strategically sought or created, to facilitate evasion behaviours. The extent to which evasion results from taking advantage of incidental opportunities, versus actively seeking or artificially creating opportunities reflects the varying degrees of strategic planning that underpins evasion behaviours. It represents an important variable to differentiate between types of business tax evader:

- For some, there is little or no strategic planning involved, with evasion only occurring where the opportunity naturally (and obviously) presents itself. For example, if a customer states a preference to pay in cash, or where stock normally required for the business is also needed for personal use (such as household goods). In these cases, there is no perceived requirement to ‘stay under the radar’, since behaviours are adopted with little considered thought

*“Because of the industry that we’re in, it’s quite hard to put things through the books to gain anything really, it’s only diesel or materials. You can only paint your house so many times, can’t you?” (Small Business, Construction)*

- In other cases, opportunities to evade tax might be considered but not actively sought or created. For example, cash is taken ‘off the books’ where it is possible to do so, personal expenses are put through the business ‘with justification’, and there is an acknowledgement that these behaviours constitute evasion, with a considered sense of what might ‘raise a red flag’ versus what the business can ‘get away with’.

*“If I was updating a computer at home I’d bring the [old] computer to here and I would buy a new computer for home [through the business]... It’s not a lot of money but it still goes towards our household, if I don’t need to pay for that computer. Also, the other advantage is that now, I get the VAT back. If I go out and buy a £400 computer, £80 of that will go towards the VAT bill.” (Small Business, Health and Beauty)*

- In extreme cases (and perhaps less frequently), the business might actively have sought or created circumstances that enable tax evasion, beyond the more obvious or incidental opportunities. For example evaders may actively ask customers for cash payments to keep work off the books, systematically put personal expenses through the business to deliberately reduce tax liabilities, and behave in a calculated and considered way to avoid detection. *“I was thinking, ‘Hold on a minute...I’ve got a brand new motor outside and I’ve put that through the business [paid for with proceeds from undeclared income], but then it’s not corresponding to how much I’m earning. That’s why, now, everything goes through the business, apart from the cash jobs.” (Small Business, Business Services)*

#### 4.1.6 External Influences

The five core attitudinal dimensions described above reflect the mind-set which underpins a business’ fundamental approach to tax management or compliance, but they alone did not account for the specific behaviours adopted by the businesses we spoke to. External influences were also found to interact with attitudinal variables, serving to further shape and reinforce certain tax evasion behaviours and rationalisations. The most important of these (based on the 45 businesses interviewed for this research) appear to be social norms, media noise, market influences and agent use.

##### **Social Norms**

Pervading social norms ‘give businesses permission’ to evade in certain situations where evasion is believed to be widespread and therefore it is considered to be normal and acceptable behaviour for businesses like theirs, for example;

- Under-declaring a proportion of low value cash transactions, where these represent a ‘normal’ payment method for that business
- Over-claiming on personal (but related) expenses - i.e. those which *could* feasibly have been generated by activities regularly undertaken by the business.

*“There are instances where, if I provide a van for somebody, it probably should go on the P11D but I don’t put it on there. Maybe that’s wrong because, I just see a van as a business thing although he is probably using it personally.” (Small Business, Business Services)*

Social norms can also serve to re-define evasion. Some businesses interviewed suggested that social norms had increased perceived acceptability of evasion in particular circumstances by creating the belief that fully compliant businesses are a minority, with evasion therefore seen as;

- Not only normal, but also a sensible business practice  
*“Everyone is bent. I do work for all types of people teachers, doctors, lawyers they’re all bent. If I say to you: ‘look I can save you money if you pay for part of this job in cash are you going to turn it down? Why would they? Would you?’ (Small Business, Construction)*
- Doing something which is deemed as ‘perhaps a bit naughty’, rather than committing a crime with broader consequence.  
*“Occasionally he stays out [at hotels, on non-working days], but he’s not taking the Mickey with it. It’s just, like, everyone does it, don’t they? Pretty much.” (Small Business, Distribution)*

The extent to which social norms influenced behaviour related directly to the perceived reputational risks associated with tax evasion, which varied significantly by sector and business type. For example, evasion was apparently perceived as more acceptable in certain types of business (such as smaller businesses with a consumer customer base), and less acceptable in others (for example where there was a risk of perceived reputational damage in the eyes of the customer, as might be the case for those with a business customer base).

### **Media Noise**

Social norms were typically experienced at a local level, but more ‘globally’ media coverage of tax disputes also appeared to reinforce evasion behaviours. Tax avoidance and evasion is a high profile topic, both in mainstream media and increasingly, social media.

Taking what they see and hear as points of reference, businesses frequently cited: large corporations who they believed had ‘cut favourable deals’ with HMRC to lower their taxes, and individuals in positions of power (such as politicians) who they felt had ‘abused the expenses system’.

Mainstream and social media coverage of high profile tax disputes both appeared to have influenced the behaviour of those interviewed, by:

- Reinforcing the view that evasion is low risk. Creating a perception that HMRCs focus must be elsewhere (i.e. not on Small and Mid-Sized Businesses) and perpetuating the perception of a lack of (known) consequences for evasion, which were rarely noted as being publicised in the same way
- Making it easier to justify evasion behaviours by perpetuating the sense that there is ‘one rule for them and another for the rest of us’. That there are others who are avoiding and evading tax on a much more significant scale.



*“There are companies out there who aren’t paying anything...the big firms that don’t pay a penny, well, they pay £5 million instead of paying a billion, and I just think, ‘Stop coming after the likes of me, when I’m paying my fair share!’”*  
(Mid-Sized, Business Services)

### Market Influences

Market pressures were found to increase engagement with evasion (and/or reinforce justifications for it). Perceived market pressures to evade included:

- **Competitive landscape** - perceived pressure to match lower prices offered by competitors who were either below the VAT threshold, or evading tax and passing on the savings (in turn this may influence customer expectations, reinforcing market pressures)
- **Economic climate** - for some, the economic crisis of 2008 represented a clear tipping point for evasion behaviours. Once adopted, evasion behaviours can become normalised within a business, persisting long-term
- **Cash flow or income fluctuations** - similarly, temporary cash-flow problems and fluctuations in income were also shown to act as a trigger (or justification) for evasion for some, once again with the risk that a short term solution becomes a long-term habit

*“It’s do that [evade] or have no business at all. To be honest I would rather do that, get through this tough couple of years, then we’ll be okay.”* (Small Business, Services)

### Agent Use

Amongst those businesses interviewed, agent use served to either influence or moderate tax evasion behaviours. This usually depended on the primary driver for the business using the agent, be that:

- Offering peace of mind by ensuring the business’ financial affairs appear to be in order (i.e. keeping the business ‘safe’ from prosecution)
- Ensuring that the business doesn’t pay any more tax than it needs to

A minority appeared to engage in evasion on the advice of an agent (who might for example point out personal expenses that could be put against the business), but for the most part agent involvement served to moderate evasion behaviours (i.e. by preventing personal expenses from being put through the business).

Businesses typically chose not to inform agents of any activities which were known to be high-risk evasion, since it is understood that agents would not be comfortable with the level of risk involved.

Ultimately, how the agent was used (and the extent to which their advice was followed) was determined by the business’ attitudes and perceptions in relation to tax.

#### 4.1.7 Evasion behaviours

Core attitudinal dimensions and external influences work together to drive a range of tax behaviours (and justifications for those behaviours). Within the sample of businesses interviewed for this research, there were a range of tax evasion behaviours in evidence as summarised by the three main categories below. Businesses varied in the extent to which

they engaged in each, with some operating across all, and others limited to one or two categories.

### Understating turnover

Not limited to, but often associated with work that is paid cash in hand. Money is either 'pocketed' for personal spend (low value amounts), or put back into the business. This may take place at the request of the customer (to reduce their bill by removing VAT), or be driven by the business (specifically to reduce the business' tax liabilities).

*"Well, I would say half of it [is work done off the books and income not declared]. It is 50%. It used to be a lot more. It has changed because, obviously, well, it was, I would say 80% of it, used to be cash-in-hand and that, but because of the way clients have got building companies, they need proper invoices now" (Small Business, Business Services)*

### Overstating costs

Costs are typically overstated by claiming for a range of personal expenses through the business (including vehicles, fuel/mileage, restaurant bills, hotels, flights, electrical goods, or even domestic cleaning/ gardening) so as to reduce tax liabilities. Costs may also be overstated by taking business stock for personal use (for example, household goods or building supplies to be used for home projects).

*"I might put through a car bill that might belong to my wife, for example, I'll put that through. I might put through a mobile phone bill that belongs to my daughter, I might do that. Yes, it's all minor stuff, nothing major, but it's stuff that will make a difference personally" (Small Business, Business Services)*

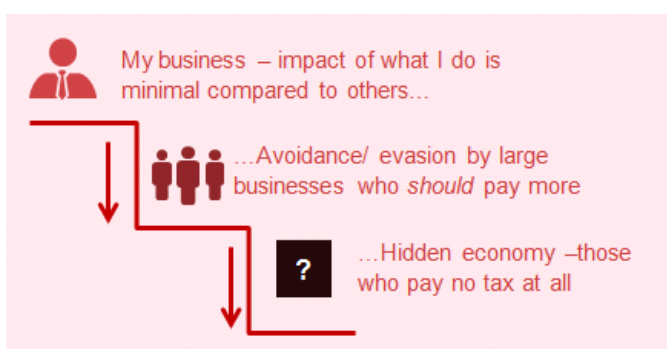
### Understating employee earnings

This may include not putting certain members of staff through PAYE at all e.g. family members, casual workers, or part-time employees. It could also involve under-reporting hours worked (paying some shifts in cash 'off the books'), to reduce total tax paid to the benefit of both the business and the employee.

There were also examples of more complex evasion strategies amongst a minority of businesses interviewed (for example, purposely not reporting improvements to business premises to avoid increases in business rates or illegitimate use of off-shore accounts), typically adopted alongside at least one of the three main categories of evasion described above.

#### 4.1.8 Justifications/rationalisations for evasion behaviours

Although all businesses interviewed were engaging in deliberate tax evasion, they did not always view themselves as 'real' evaders (see *Figure 2* below):



*Figure 2 demonstrates the finding that regardless of the nature and extent of evasion taking place, businesses interviewed for this research would always refer to what they believed to be 'more significant' examples of evasion in justifying their own behaviour.*

Most of the businesses we spoke to engaged in downward comparisons when justifying their evasion behaviour; there's a perception that there is always someone who's doing something worse.

As such, evasion was often justified on the belief that the financial impact of what they do is minimal compared to other known examples of evasion, such as:

- The tax avoidance/evasion activities associated with larger businesses that they read about in the media; and/ or
- Other businesses in their area/industry who they believe are paying no taxes at all (i.e. those operating within the hidden economy)

These comparisons help business to minimise their perception of the evasion behaviours they engage in and often underpin the justifications or rationalisations given for engaging in evasion behaviours

*“Look, there are certain people that are doing something naughty all the time, that actually are part of the ‘grey’ economy, in fact, they are the grey economy. Those are the people that HMRC should be going out and finding.” (Mid-Sized, Construction)*

**Stated justifications or rationalisations for tax evasion given by Small and Mid-Sized Businesses typically fall into six common themes;**

- *Downward comparisons, and an assumption that others evade more*
  - Small and Mid-Sized Businesses often focus on the taxes they do pay, and assume that their own evasion accounts for ‘only a small amount’ compared to other ‘real’ tax evaders
- *A sense of ownership over the money coming into the business (‘my money’)*
  - Many feel there should be more incentive to being in business and so feel entitled to ‘little extras’ here and there – with tax not taken at source it becomes difficult to hand over what feels like ‘my money’
- *The belief that evasion is essential to the sustainability/growth of the business*
  - Some believe they are left with no choice but to evade, either because the business would not survive if they paid all their taxes or because they think the business would simply ‘scrape by’ and not grow
- *Offering a competitive price to customers*
  - Competitors’ behaviour is used to justify evasion, based on the assumption that others are also evading, therefore to not do so would leave them at a competitive disadvantage
- *A sense that there is no difference between business and personal money and assets*
  - Evasion is justified through a lack of distinction between business and personal finances (where there is no perceived need to keep them separate)
- *Belief that evasion is normal, and something that everybody in business does*

- Evasion is felt to be endemic in society (driven partly by media noise), and/or, normalised in certain industries, creating a sense of *'if you can't beat them, join them'*

## 4.2 Four emerging types of evader

Through analysis of variation across the core dimensions, external influences, subsequent tax evasion behaviours, and evasion justifications presented across the sample of 45 businesses interviewed, this research identified four emerging types of evader (see *Figure 3* below):

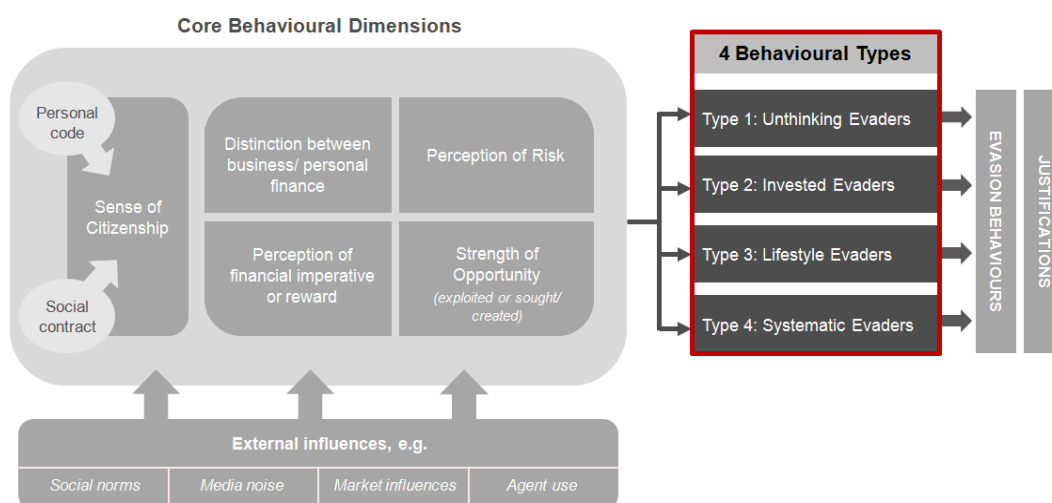


Figure 3.

This is a reprise of the original model shown in Figure 1, with the four types of evader now adjacent to the five core dimensions and external influences.

The subsequent sections outline each of these types in more detail, drawing particularly on the specific dimensions which best define each character.

### 4.2.1 Unthinking Evaders

**'Unthinking evaders' were defined by low-level, habitual, evasion which was often adopted without thought.**

#### Core dimensions

- Sense of Citizenship: Evasion behaviours were heavily curtailed by a strong sense of citizenship;
  - Strong social contract, driven by deference to state and sense of duty
  - Evasion behaviour is therefore at odds with self-image (of a conscientious and 'law abiding' citizen)
  - The recognition that behaviours do constitute tax evasion sometimes created cognitive dissonance (at interview); whilst known and understood, obligations were perhaps not top of mind.

*“I mean, I know I have done a little bit of tax evasion, but I’m not the type of person to do that on a weekly basis, because like I said to you, I’ve got too much to lose. I know, subconsciously, what the consequences are, but I don’t think me as a person would do that anyway, because I’m not that type of person.” (Small Business, Construction)*

- ii. Business vs. personal: Evasion was driven predominantly by blurred lines between business and personal finances
- Usually these were very small or family run businesses with no perceived need to separate business and personal affairs. The value of the business is therefore intrinsically bound to the value of the individual/family – that is, it is all seen as ‘one pot’

*“Toilet rolls, coffee those sorts of things will go through together [when I do the weekly shop for the business] and I’ll take a couple home” (Small Business, Retail)*

- iii. Perceived risk: Evasion behaviours were not consciously recognised, and therefore neither were the risks
- Behaviour was only acknowledged to be evasion when given proper consideration under interview
  - Since most evasion is low level and adopted without thought, the risks were not top of mind
  - These businesses had a very low tolerance for risk – anticipated consequences for a business found to be evading were feared to be severe
  - Nevertheless, the extent of their own evasion was considered to be of little interest to HMRC

*“I wouldn’t do the extreme. I couldn’t, to be honest... I have five children, I’ve got too much to lose. They need me as much as I need them, so it’s not worth the risk to do it to the extreme.” (Small Business, Construction)*

- iv. Financial Imperative: There was very little (acknowledged) financial requirement to evade
- Financial benefits of evasion were not given much consideration; evasion was deemed to be low value, and not consciously factored into financial planning
  - However, established habits potentially make it hard for these businesses to recognise the actual financial impact of their behaviours

*“Over Christmas, because the business was actually quite quiet and we didn’t have any money to take out for wages, we did use [the business card], because we went out with family and we put the meal through the business.”*

- v. Opportunity: No attempts were made to influence or artificially create opportunities to evade
- Evasion only took place where the opportunity to do so was readily available, requiring no thought or planning, e.g.
    - customer had a strong preference to pay cash
    - ordering stock anyway for business, but ordered extra for personal use

*“I mean, I don’t put fake invoices in, but if I’m re-decorating the house and we’re ordering paint, we might order an extra tin to use at home, but why not?” (Small Business, Construction)*

#### External Influences referenced by Unthinking evaders:

- Market Pressures, relating to price matching non-VAT registered competitors, or wanting to offer a ‘fair price’ to certain customers (for example, doing an undeclared cash job to avoid charging VAT)
 

*“To help a local family, we wouldn’t charge them. It would be cash” (Small Business, Construction)*
- Social Norms, typically stemming from;
  - Established or inherited, habitual behaviours
  - Belief that certain evasion behaviours are understood to be commonplace within a particular industry
 

*“It’s almost like a culture within certain cash oriented businesses”*
- Agents were typically relied upon for peace of mind, to help keep the financial affairs of the business in order; in doing so, agents might have helped to identify costs which could be off-set against the business, but there were also examples where agents had limited evasion behaviours by highlighting the risks and suggesting more legitimate options.

#### Behaviours

Evasion was typically limited to low frequency/low value activity;

- Taking business stock for personal use
- Putting some personal expenses through business (where the expense could legitimately be applicable to both)
- Occasionally under-declaring income, where customers request to pay in cash

But potentially, occasional higher value evasion was taking place (e.g. cumulative value of fuel used for personal use)

#### Justifications

Unthinking evaders were often (though not always) smaller businesses, e.g. ‘one-man bands’ or family run, and this characteristic underpins drivers and justifications given for evasion. For some, it simply did not seem logical or appropriate to separate business and personal affairs and finances.

Attitudinally, these businesses were (relatively) compliant, and despite their admission of engagement with evasion, they still tended to see themselves as such.

### **4.2.2 Invested Evaders**

**Invested evaders saw their evasion as an unfortunate financial necessity to stay in business, but believed that the end justifies the means.**

#### Core Dimensions

- i. Sense of Citizenship: Invested Evaders typically presented a reasonably strong sense of citizenship, but this has been undermined by financial circumstances;

- The perceived unfairness of their situation (tax burden, lack of support) may have been attributed to ‘the state’, resulting in erosion of the social contract.

*“There’s no point in even trying to work hard anymore. I totally understand these people that will stay on benefits for the rest of their life, because it’s easier” (Small Business, Animal Husbandry)*

- ii. Business vs. personal: In most cases, any lack of distinction between business and personal finances was to some extent intentional. For example, putting personal expenses through to consciously and deliberately reduce liabilities, in keeping with a general mind set to make savings wherever possible;

*“If I’m being totally honest it probably shouldn’t go through, but actually because I have used little bits for the business, it can go through.” (Small Business, Animal Husbandry)*

However, financial pressure was often felt within their personal lives, making the boundary between work and personal finances feel less relevant, and further blurring the distinction between the two.

- iii. Perceived risk: Risks of evasion were often recognised, but were off-set by anticipated financial consequences of not evading;
  - More likely (than other types of evader) to acknowledge potential risks, but the likelihood of getting caught was still assumed to be low
  - Either way, the perceived financial need had created a sense that they had nothing to lose (and the belief that they would lose the business anyway)

*“Really it’s a big risk because it’s my whole livelihood and its people’s jobs on the line really, but on the other hand it’s do that or have no business at all.”(Small Business, Services)*
- iv. Financial Imperative: Financial pressure to keep money in the business was the primary trigger for evasion
  - Perceived financial pressure was genuinely believed to represent a real and present challenge for the business
    - either to allow the business to grow and succeed
    - or in some cases, simply to keep the business afloat
  - As such, evasion had become a ‘normal’ part of financial management
  - However, the financial gains of tax evasion were not felt to offer any personal reward beyond this

*“When you get a tax bill, you have no choice, you have to pay, there is no hiding place. The only way you can keep your head above water is you under declare...Like a few thousand pounds...That money goes back into your pocket, and that’s how you stay afloat.” (Mid-Sized Business, Manufacturing)*
- v. Opportunity: Evasion typically reflected a conscious and deliberate effort to reduce tax liabilities
  - Businesses had often considered all opportunities to reduce their tax bill, both the immediately obvious (e.g. not declaring all cash income) and the more thought through (e.g. not putting all staff or staff hours through PAYE)

- They would consciously take advantage of any opportunities that naturally presented themselves
- However, these businesses would stop short of actively creating complex evasion strategies

*“I do put cash through. I don’t just keep it all for myself. I’ll just minimise it. So, for argument’s sake, if [a customer] pays, I don’t know, £60 cash one week, because we’ve had a few hours, I’ll just put it through as, like, half hours, and just put half through [the books].” (Small Business, Services)*

#### External Influences referenced by Invested evaders:

- Market pressures, often relating to business life events, such as:
  - Business growth which had caused the business to hit certain financial milestones, e.g. hitting the VAT threshold and experiencing pressure to compete with other non-VAT registered companies
  - Financial difficulties resulting from loss of a contract

*“That’s the only reason I put some in my pocket, because we’ve reached that threshold and I cannot physically live without it.” (Small Business, Services)*

- Media noise, which had further eroded the social contract, lessening sense of duty to the state and providing justification for evasion behaviours, based on the belief that other businesses are ‘*getting away with it*’
- Agents, who might have been engaged to provide peace of mind, but typically with an added expectation that the agent would also offer the business advice on ways that it could legally reduce its tax obligations.

#### Behaviours

Invested evaders were engaging in evasion behaviours, wherever the opportunity to do so presented itself, but stopped short of engaging in behaviours they believe could raise suspicion. Examples included:

- Back dating invoices to hold-off paying VAT, typically a tactical approach to help manage cash flow
- Understating cash income, typically low–mid value amounts for specific jobs (for example, a building company might report not declaring one ‘smaller’ – i.e. <£4,000 - job out of four)
- Claiming on some personal expenses where they feel these could be justified if necessary (for example, some groceries/household goods, personal mileage, or low value recreational costs)
- Not putting all staff (or all staff hours) through PAYE, for the mutual benefit of employee and business

#### Justifications

Perceived financial necessity was both the primary driver and main justification for engaging in evasion behaviours:

- Businesses felt they had no choice but to evade some of their tax obligations, in order for the business to survive or grow



- Evasion behaviours were at odds with attitudinal levels of compliance, but there was a strong belief that without evasion the business would fail to succeed, or in some instances close down  
*“I’ve always been brought up to be law abiding and so to go against it is very much against my beliefs, but in actual fact, if I don’t do this I’ll have no business left.” (Small Business, Services)*

### 4.2.3 Lifestyle Evaders

**Evasion enabled a life-style otherwise out of reach, but was felt to be justified by the taxes that are paid.**

#### Core Dimensions

- Sense of citizenship: Lifestyle evaders presented a relatively strong sense of citizenship, but ‘compliance’ was on their own terms;
  - Their sense of duty was adequately satisfied by their current level of contribution (i.e. the amount of tax that they do pay)
  - The taxes they did pay were paid because paying tax is believed to be ‘the right thing to do’
  - But they were working to their own definition of what’s due, balanced against perceptions of the ‘take-home salary’ they believe they have earned  
*“If the business has had a good month, then I’ll think, ‘Yes, I want to have a treat.’ I don’t increase my salary for that month. It’s set. That’s the way it is.” (Small Business, Health and Beauty)*
- Business vs. personal: There was generally a recognition that the business is financially separate, but Lifestyle evaders frequently took advantage of opportunities to push the boundaries;
  - Any lack of distinction between business and personal was, to some extent, intentional, i.e. putting personal/ family expenses through where possible to consciously and deliberately reduce liabilities
  - Access to any benefits an individual/family can take from the business was seen as a just reward for running the business, for example;
    - mobiles/ laptops for family members paid for through the business
    - fuel/ mileage allowance for family cars
- Perceived risk: Any risks associated with evasion had been considered, but were assumed to have been managed and mitigated. Evasion behaviours were believed to be safe on the basis that, either;
  - they are undetectable
  - they could defend it if required (since there is no irrefutable ‘proof’ that what they were doing is wrong)
  - Agent involvement may also have provided a sense of security (on the basis that the agent would not allow anything to appear on record which could cause problems later)  
*“If it [being caught] happens, it’s going to be very, very hard to prove, because it’s not that bad, and I’m not a massive, huge company. I don’t make huge amounts of profit, you know?” (Small Business, Communications)*

- Lifestyle evaders would draw the line at any evasion behaviours they felt they didn't have a good chance of justifying, if they needed to

*"I think every single one of those I could justify... I revert it back to saying, 'What do clients need in my business?' So I wouldn't put anything through for myself if it wasn't something that was going to be [or could also be] used in the business." (Small Business, Health and Beauty)*

iv. Financial Imperative: Perceived financial pressure was driven by personal/family life (and aspirations), rather than a critical business need;

- Motivated by personal reward, which might range from
  - compensating for a low personal income (to enable low value 'treats', such as a family dinner, or assist with cost of living), to
  - affording high value expenses, such as holidays/travel

*"Because I don't earn enough money. The accountant said to me if I put any more money through the business, to earn, the business won't be able to afford it, but then I still need to make sure that I support my family. So this is the only way to support my family and treat them." (Small Business, Health and Beauty)*

- As such, financial gains were assumed (and budgeted for) in the standard of living adopted, and decisions around desired take-home income may have influenced tax planning

*"£2,000 - £3,000 a year is nothing to be sniffed at. You can go on a holiday with that. Are you with me?" (Small Business, Engineering)*

v. Opportunity: Evasion reflected a considered effort to get as much out of the business as possible, both in terms of take-home income and personal/family benefits

- Efforts were made to consider all benefits that the business could enable, beyond legitimate opportunities (whilst keeping 'under the radar')
- In some cases, agents may have played a role (whether knowingly or not) in raising awareness of opportunities or flagging risky behaviours
- However, these businesses stop short of actively creating complex evasion strategies

*"If I'm planning a holiday, I'll look into where I want to go and find out what goes on there, so that I can justify putting it through the business." (Small Business, Automotive)*

External Influences referenced by Lifestyle evaders:

- Media noise: By perpetuating the belief that other (larger) businesses find ways to avoid/evade tax, high profile media disputes appear to have reinforced the idea that evasion is commonplace, and given these businesses greater credence to the concept of being 'compliant' on their own terms.
- Social norms: The belief that evasion (to some degree) happens in most businesses has seemingly reinforced the sense that it is normal to expect some personal benefits to running a business.
- Agents were often relied on to limit the tax obligations of the business, and expected to find every possible loop-hole that they can legitimately use, whilst

keeping the business out of trouble. However, businesses rarely involve agents in any activities which are known to constitute evasion.

### Behaviours

As with Invested evaders, Lifestyle evaders were typically engaging in evasion behaviours wherever the opportunity to do so presented itself, but would stop short of that which might raise suspicion, or take them into territory that went against their self-image as a business which contributes its fair share to society;

- Not declaring all cash income, typically amounting to low–mid value sums (so as to avoid raising suspicion)

*“When I do my private hairdressing, that either goes in my personal bank account, or I use it basically towards holidays and stuff.” (Small Business, Health and Beauty)*

- Frequently over-claiming on expenses, putting personal items for family members or the home through the business, e.g. meals with the family, iPads for children, non-company cars, work carried out on the home, etc.

### Justifications

Lifestyle evaders were more likely to be well-established and/or prospering businesses. The amount of tax they were required to pay, would often underpin their drivers and justifications for evasion:

- Businesses in this type feel that they are heavily taxed and that the amount they *do* pay constitutes a large proportion of the tax that they *should* pay (making a significant contribution to society)
- This was reinforced by the belief that there *should* be some personal reward for running their own business

*“I thought, okay, well my family’s going for a meal for four, so that can come off the business. I work hard enough. I work long enough hours. Why shouldn’t I have a treat?” (Small Business, Health and Beauty)*

#### 4.2.4 Systematic Evaders

**Evasion was integral to the business, actively considered, and systematically applied.**

##### Core Dimensions

- i. Sense of Citizenship: For these businesses, sense of citizenship was not, in itself, motivating in terms of tax compliance;
  - Systematic evaders would typically believe that they are independent of the social contract (not reliant on the state)
  - As such, they were not particularly compelled to pay taxes through a sense of duty or obligation
  - Any tax paid, appeared to be paid predominantly to project the image of compliance

*“I pay far too much tax anyway, so I don’t think I should have to pay more, it’s already far more than other people pay. If I play the system then I don’t see anything wrong with that.” (Mid-Sized Business, Technology)*

- ii. Business vs. personal: Systematic evaders were fully cognisant that the business is financially separate, but doing all that they could to ensure potential personal/family benefits were fully maximised;
  - Any overlap of business and personal interests was entirely calculated and intentional, with personal expenses routinely put through the business to facilitate tax evasion
  - Systematic evaders were likely to push this further than any other type, in terms of both frequency and value.
- iii. Perceived risk: Risks associated with evasion were carefully calculated and considered, resulting in a higher tolerance for risk than for any other type. Evasion was carefully researched and calculated, with risks assumed to be mitigated on the basis that;
  - Evasion was undetectable
  - They understood how to ‘play’ the system sufficiently to stay out of trouble
  - They believed that the financial reward would outweigh any (anticipated) potential financial consequences

*“HMRC doesn’t really know what’s going on and they aren’t very good. It’s easy to get round the system and keep off the radar, although tax transparency laws are making it more difficult.” (Mid-Sized Business, Technology)*

- iv. Financial Imperative: Financial pressure reflected a desired standard of living, rather than a critical business need
  - More financially comfortable than other types of evader, but business evasion enabled lifestyle choices otherwise out of reach (for example, affording high value purchases, such as holidays)
  - These financial gains were assumed (and budgeted for) in the standard of living adopted, with decisions around personal (or family) financial gain becoming integral to tax planning
- v. Opportunity: The considered implementation of evasion behaviours (even extending to the creation of artificial and illegitimate opportunities to reduce tax liabilities) was a key feature of businesses who represented this type;

- They were investing time and effort to make sure that the business identified every available opportunity (creating additional opportunities where possible) to pay less tax
- Complex evasion was meticulously planned, with implementation often requiring;
  - financial literacy/ capability
  - financial liquidity

*“I keep my affairs pretty complicated, as sophistication is a kind of protection. I had - until the end of last year – an offshore company which I had been using for a few years, but have had to close that down now due to transparency laws. I could easily use that to get round the system. Overall I saved about £250,000, which probably cost me about £30,000 in local administration charges for the company.” (Mid-Sized Business, Technology)*

#### External Influences referenced by Systematic evaders:

- Media Noise:
  - These businesses were acutely aware of the evasion activities of other businesses as portrayed in the media, resulting in a perception that those caught evading (large amounts of) tax have been able to ‘negotiate a deal’ with HMRC – further damaging perceptions of HMRC as a credible threat
  - Furthermore, negativity around public spending as reported in the media appeared to further erode their (already compromised) social contract.
- Agents: Whilst agents were used to oversee compliant aspects of the business, evasion behaviours were not usually disclosed to agents – Systematic evaders were typically informed enough to know that agents would not be able to tolerate the level of risk they would be exposed to

#### Behaviours

Systematic evaders engaged in evasion behaviours wherever the opportunity to do so presented itself, actively seeking opportunities to push this a step further. As a result, the evasion behaviours they engaged in were typically more extensive than amongst other types, both in terms of range, frequency and value.

- Behaviours which fell within undeclared income and over-claim of expenses were systematically applied across the business
- But, there was also some evidence that these businesses would actively create and implement complex evasion strategies, including one example of purposeful avoidance of business rates, and another of illegitimate use of off-shore accounts.

#### Justifications

Systematic evaders did not feel any particular obligation towards the state, based on the belief that they took very little in return for their contributions (which - despite the level of engagement with evasion - were believed to be significant).

*“My wife is expensive...and it’s my money anyway, they take far too much already and I’m just making sure I don’t pay more than I have to.” (Mid-Sized Business, Technology)*

This view point was exacerbated by the perception that evasion is commonplace, further eroding the social contract.

### 4.3 Movement for typology migration

Although it was outside the scope of this research to draw any definitive conclusions about how a Small or Mid-Sized Business might move between the four types (businesses were not interviewed on this basis), it is likely that changes in circumstance could result in such migration.

Figure 4 below presents a hypothetical view of how businesses might migrate from one type to another. It is important to stress that this reflects a hypotheses drawn from an analysis of interviews conducted, and is based on assumptions around the impact of circumstantial shifts (rather than reflecting any potential movement that could be initiated by HMRC interventions intended to improve compliance).

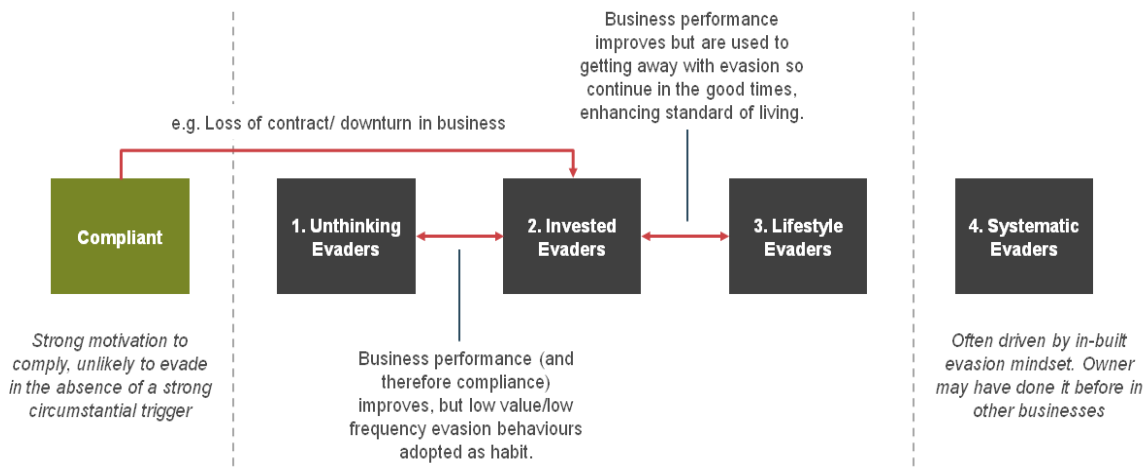


Figure 4.

### 4.4 Driving Behavioural Change

A number of specific approaches to driving behavioural change (drawing on ‘promote, prevent, and respond’ initiatives) were evaluated on the basis of awareness, understanding and impact (both in terms of overall impact, and looking at any differences by evader type).

Across all those measures tested the biggest barrier to impact appeared to be the perceived likelihood of getting caught. Regardless of type, the majority of businesses interviewed for this research strongly believed that there was little (or no) chance of their evasion behaviours being detected by HMRC, based on one or more of the following assumptions;

- HMRC's current focus is on bigger businesses, where the greatest value, in terms of scale of evasion (and therefore revenue at stake), is presumed to be
- The level of evasion they engage in is too small for it to be worth HMRC's time to investigate
- HMRC currently lacks the resources and finances to pursue businesses who evade tax

*"You're not going to wipe it out. They haven't got the man power, and they haven't got the knowledge to do it.... They just can't prove it!" (Small Business, Distribution)*

Even if they were to come under investigation by HMRC, most of those interviewed believed that there would be no serious implications, given that;

- They could defend their position if necessary
  - "Even Dad's buying cases of beer and wine and stuff at Christmas, okay we'll keep some ourselves, but they'd never know that wasn't for clients. They wouldn't say, 'Well who did you give that to, and who did you give that to?'" (Small Business, Distribution)*
- The evasion would be difficult (if not impossible) to prove, since:
  - under-declared income is 'invisible'
  - over-claim on expenses could be justified if required

A small minority had been investigated in the past, with no evasion detected. One had first-hand experience of being caught, but they had not been deterred from continuing to evade tax altogether. However, it should be noted that the majority of those interviewed were using any undeclared income in day-to-day spending, or paying it back into the business (e.g. paying for staff or supplies). It is possible that where larger sums of money are placed into wealth rather than short term spending – for example, in bank accounts or high value assets – the associated paper trail creates greater levels of concern (indeed, Systematic evaders moving greater sums of money around seemed to have greater recognition of the potential consequences of investigation).

Regardless of the intervention tested, the over-riding belief that 'we would never get caught', and even if we did 'HMRC simply couldn't prove it' meant that the potential impact on businesses' behaviours was limited.

#### 4.4.1 Financial penalties

- Most were aware that financial penalties are possible, or at least guess that they could be
- But few had any understanding of the potential scale of financial penalties:
  - as such the risks were downplayed as something which would be offset by the financial gains of the evasion itself
  - this may be confounded by experience/knowledge of late payment fines, and the assumption that a financial penalty for evasion would be comparable
- It seemed that financial penalties could be sufficient to change behaviour if:
  - they were understood to represent a tangible financial impact

- they were seen to be actively enforced and felt like a real threat for all forms/levels of tax evasion (not just for high value evaders)

*“Look, if you don’t get caught, you don’t pay anything. If you do get caught, you’ve just got to pay it back.’ So it speaks for itself, doesn’t it really? It’s like what have you got to lose, really?” (Small Business, Distribution)*

#### 4.4.2 Prosecution

- Almost all businesses were aware that prosecution is a possible consequence of tax evasion *for some*, but believed that this outcome was only applicable in extreme cases
- There was very little understanding of the particular circumstances where this might happen; prosecution was therefore assumed only to be relevant for larger businesses or more serious cases of evasion  
*“If you’ve evaded a lot of money. We’re talking thousands. Like with Google. How they’re getting away with it, I don’t know? They’re not in prison?” (Small Business, Business Services)*
- Prosecution appeared to have potential to act as a real deterrent, but to actually impact on behaviour it would need to:
  - be actively and publically visible as a potential consequence
  - feel possible for all, not just those engaging in the most serious examples of evasion

*“That to me would be terrible, because I’ve got two children and a wife. So to me, if they said to me, ‘Right, okay, you’ve been caught doing this. Next time it happens you’re going to go to prison.’ I probably would end up selling my business and saying, ‘You know what? I don’t want to do it anymore.’” (Small Business, Health and Beauty)*

- Offering evaders an opportunity to disclose incidences of non-compliance to HMRC with guaranteed immunity from prosecution (but still having to pay a fine) seemed to have very little impact on behaviour, based on the assumption that prosecution doesn’t represent a genuine and relevant threat

#### 4.4.3 Publication

- There was a reasonable level of awareness that HMRC has the power to publish details of those businesses caught evading tax
- However, understanding was limited, raising fundamental questions around where the information would be published, and whether this would be online or offline (or perhaps more importantly, who would see it)
- The extent to which publication represents a compelling reason for behavioural change seemed to be dependent on the extent to which reputational risks are a consideration for the business
  - On a national scale, impact was limited; most assumed that their behaviour would be of little interest to anyone else, and a minority even referred to it as a badge of honour in their sector  
*“I don’t want it to happen but if it was to happen, well we’re only a little company in a very big country so I don’t think anyone would know who we were or whatever.” (Small Business, Services)*



- Publication had a greater impact when the risk was localised, particularly for those businesses where reputational damage could result in loss of business and a longer term financial fallout

*“If there’s a customer that uses your business and they see it, like, because if I saw that, I would be like, ‘Oh my God. We’re not going anymore.’” (Small Business, Business Services)*

#### **4.4.4 Increased monitoring (having to submit more detailed returns, being subject to increased monitoring by HMRC for a certain period of time)**

- Although not top-of-mind, most of those interviewed recognised increased monitoring as an anticipated consequence for those caught evading tax when prompted
- Businesses would quickly comprehend what this would mean for their business
- However, as a standalone intervention this wasn’t likely to be enough in itself to change evasion behaviour
- The potential impact was also limited by a widespread assumption that HMRC simply do not have the resources to enforce such a response (and that much evasion would be difficult to detect even with this in place)

#### **4.4.5 Provision of information from HMRC (to raise awareness of the impact on public services, or challenge social norms of widespread evasion)**

Overall and compared to other more direct measures to tackle evasion and improve compliance, the provision of information from HMRC had the least impact;

- Whilst there was some (albeit limited) awareness of previous publicity campaigns, these did not appear to resonate long-term, doing very little to tangibly raise perceptions of risk
- The concept of communications designed to raise awareness of the impact of evasion on government services was not well received, and there was little to suggest that such communications would have any impact on evasion behaviours
  - Businesses already felt they were paying their share of tax (particularly against the backdrop of high profile tax disputes in the media)
  - Many were not happy with government spending, questioning the value their additional contributions would really have in the Government’s hands
- Similarly, communications designed to provide a transparent point of reference by sharing statistics about the prevalence of tax evasion in the business community seemed unlikely to have widespread impact
  - At best, it was assumed that this would do little to counter media noise and entrenched social norms
  - But at worst, this had potential to result in unintended consequences, increasing evasion behaviour by encouraging downward comparisons

### 4.5 Developing targeted strategies

There is some evidence that the potential impact of those interventions evaluated might vary by type of evader, summarised below in *Table 1*:

*Table 1. Summary: impact of interventions evaluated by evader type*

Approach	Unthinking evaders	Invested evaders	Lifestyle evaders	Systematic evaders
<b>Financial penalties</b>	<b>High</b> Threat of penalty could be effective if perceived risk level raised	<b>Low</b> Business 'need' means this poses little threat, relative to the alternative	<b>High</b> Could impact behaviour if better understood - not tangible, so offset by reward	<b>Low</b> Based on assumption that <i>any</i> fine will be offset by previous/future gains
<b>Prosecution</b>	<b>High</b> Would be a major concern if deemed <i>relevant</i> for low level evasion	<b>High</b> Could be a major concern if deemed <i>relevant</i> to business type and extent of evasion behaviour	<b>High</b> Could be a major concern if deemed <i>relevant</i> to business type and extent of evasion behaviour	<b>High</b> Could have high potential impact, if deemed possible
<b>Publication</b>	<b>High</b> Would have a significant impact if published locally	<b>Low</b> Not something which concerns them – they are evading to survive.	<b>Medium</b> Could impact behaviour if published locally (risk of reputational damage)	<b>Low</b> Not motivating - not something which concerns them
<b>Information from HMRC</b>	<b>Medium</b> Increased knowledge could positively leverage social contract	<b>Low</b> Not motivating – they already feel let down by 'state'	<b>Low</b> Already think they pay their fair share (and more than many others)	<b>Low</b> Weaker social contract so little sense of citizenship to play on

Building on earlier hypotheses about how businesses might migrate between types based on circumstantial changes (see *Figure 4*, section 4.3), we can apply this understanding of where interventions have the greatest impact to our assumptions around typology migration. In *Figure 5* (below), we reprise the diagram used to demonstrate typology migration, and overlay the potential application of targeted interventions, intended to shift behaviour towards compliance.

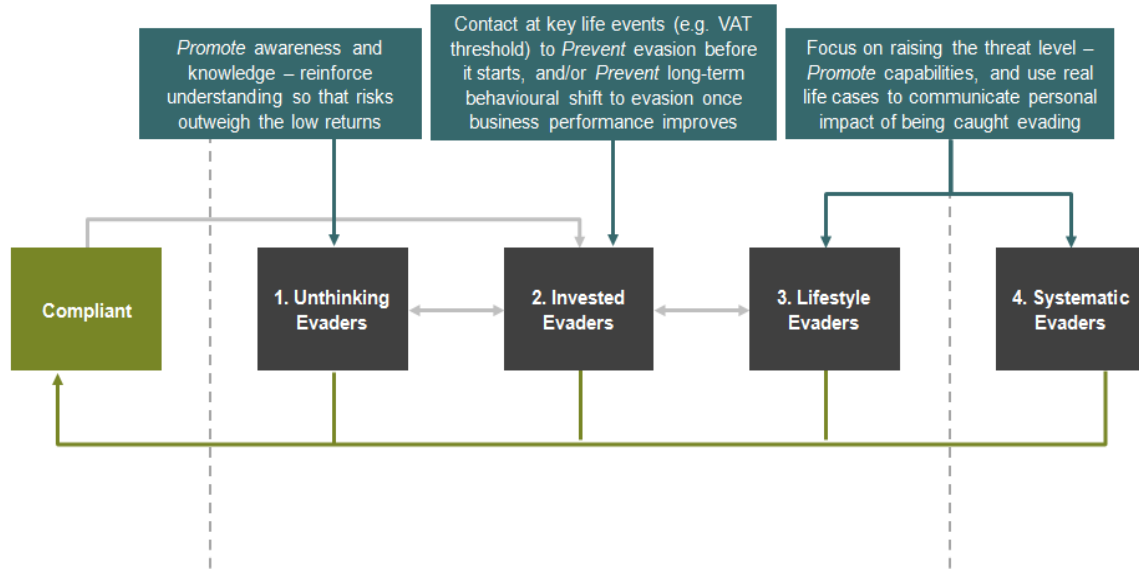


Figure 5.

A detailed overview of how a targeted strategy to tackle evasion could be developed across the typology (including an analysis of ease of influencing behaviour vs. likely impact of doing so) is provided in Table 2:

Table 2: Towards a targeted strategy to tackle evasion

	Unthinking Evader	Invested Evader	Life-style Evader	Systematic Evader
Likely ease of influencing behaviour	<b>High:</b> greater attitudinal compliance/ inherently uneasy with evasion, facilitating behavioural change	<b>Low:</b> believe financial circumstances leave no choice but evasion; as such, believe they have nothing to lose	<b>Medium:</b> driven by personal reward, not financial necessity – <i>but</i> need a compelling reason to stop	<b>Low:</b> Evasion behaviour driven by deep rooted non-compliant attitudes, difficult to overcome
Likely impact of any behavioural shift	<b>Medium:</b> opportunity <i>per business</i> to improve compliance is marginal, (limited by extent of evasion behaviours), but <i>total</i> £ value is greater	<b>Medium:</b> With few (perceived) alternatives, some may be 'unable' to change in any meaningful way	<b>High:</b> Evasion frequently takes place at a moderate to high level, so the £ value ( <i>both per business and in total</i> ) is high	<b>Medium:</b> Evasion takes place at a high level, with high £ value <i>per business</i> . But limited number of businesses have the capacity/drive to do it
Focus for developing targeted strategies	<b>Promote understanding</b> of what constitutes evasion/associated risks to <b>increase</b>	<b>Prevent evasion from starting, and/or persisting</b> long-term; Intervene at critical tipping	<b>Promote credibility/ impact of HMRC as enforcer, and of the personal</b>	<b>Promote credibility/ impact of HMRC as an enforcer and</b>

	<p><b>consideration</b> (vs. relatively low rewards)</p>	<p>points with credible alternatives and disincentives (focusing on impact beyond the business, e.g. on employees/ family)</p>	<p><b>ramifications</b> of being caught evading (beyond the tangible intervention itself)</p>	<p><b>target 'Respond' initiatives</b></p>
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## 5. Conclusion

The research identified several potential barriers to the impact of interventions, which must be addressed – namely; perceived likelihood, understanding, and personal ramifications of any given consequence. While the majority of small and mid-size businesses comply with their tax obligations, the diagram below (Figure 6) shows a potential strategy to address the small proportion who engage in evasion::

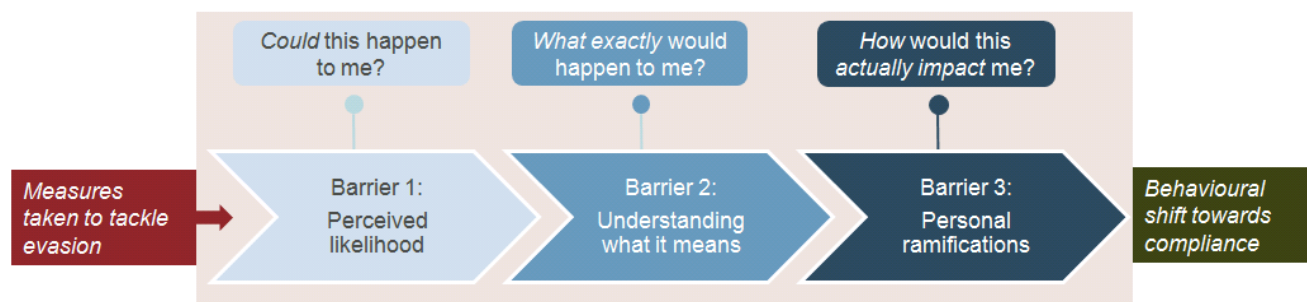


Figure 6.

### What does this mean for HMRC?

- Actions intended to tackle evasion and improve compliance, including ‘*Respond*’ approaches, could be more visible and work harder to cut through the dominant media noise, social norms and market pressures in order to meaningfully impact on evasion behaviours and ‘*Promote*’ compliance

### 5.1 Step 1: Increase the *perceived likelihood* of getting caught

In order for any intervention strategy to work, there is a basic requirement for those evading to believe that there is a *real* risk that the evasion will be detected and proven.

The main barrier to effectiveness across all the deterrents evaluated as part of this research is that this is not currently the case, driven by *perceptions* that;

- The odds are in the businesses’ favour...
  - They have safety in numbers (absolute and relative)
  - Their evasion would be ‘near impossible to detect’
  - Their evasion would be difficult to prove
- ...and are stacked against HMRC
  - HMRC have dwindling resources to identify evaders
  - HMRC have limited powers of surveillance
  - HMRC do not have the capacity to fully investigate

### What does this mean for HMRC?

- The research suggests this might be addressed by *promoting*;
  - awareness of capabilities / tools available to catch those who evade
  - evidence of HMRC not only *finding* businesses who evade tax, but also successfully *taking action* against these businesses e.g. local publication of businesses who evade (although this is not directly compelling across all businesses as an intervention in itself, it is

uniquely well positioned to deliver evidence of HMRCs capabilities in a way that is both meaningful and relevant).

## 5.2 Step 2: Improve understanding of potential consequences

To provide a compelling reason to stop evading tax, the potential consequences of evasion would need to be understood (beyond the basic awareness that said consequence could be a possibility);

- For many Small and Mid-Sized Businesses who engage in evasion, the potential consequences do not represent a tangible threat, because;
  - the detail of what would actually happen is an unknown – there is little or no understanding of specifics
- Understanding of what being caught could actually mean is typically based on a limited frame of reference, for example;
  - experience of late payment fines (and assumption that a penalty for evasion must be similar)
  - media coverage, which rarely indicates consequences that are perceived to be relevant to smaller businesses (if perceived to demonstrate any consequence at all)

### What does this mean for HMRC?

- HMRC could consider *promoting* understanding of consequences of evasion, in a way which is;
  - *Tangible*; a transparent explanation of what the consequences would involve (i.e. £££ value)
  - *Relevant*; specific to size of business and/or type/value of evasion (i.e. scalable)
  - *Believable*; realistic and proportionate (i.e. recognising that not all evasion behaviours are equal)

## 5.3 Step 3: Tap into what matters, beyond the consequence itself

There is no ‘silver bullet’ for tackling evasion – more important than identifying the most effective ‘stick’, is identifying what is personally motivating – beyond the tangible consequence of any individual ‘Respond’ strategy.

In order to be compelling, interventions must be personally motivating, going beyond the immediate impact of the consequence itself, to get under the skin of what this would actually mean to the business.

The diagram in Figure 7 can be thought of as a target – with personal ramifications (and therefore potential impact of an intervention), increasing as you move toward the centre;

- At the outer-most layer, the impact of playing on an individual’s position in, or perceived responsibility towards the state (as with information from HMRC about the impact of tax evasion on government services) appears to have limited impact
- But moving towards the centre of the target, consequences have a greater impact (such as publication of evaders through localised channels) particularly where reputational risks are a consideration

- More effective still, are approaches which leverage responsibility for others, in terms of the broader consequence of a business being found to evade (for example, the impact on employees who may be innocent bystanders to the evasion taking place, but would share in the consequences none-the-less)
- But most effective are those interventions which leverage personal ramifications and broader consequences for the individual and their family, tapping into the business' sense of *'what do I have to lose?'*



Figure 7

#### What does this mean for HMRC?

- This might be addressed by identifying the right levers to pull to tap into what matters most to evaders (i.e. what would be a risk too great to bear) – which is likely to differ by evader type, as indicated in section 4.4.

## 6. Appendices

### 6.1 Detailed methodology

45 one hour depth interviews with Small and Mid-Sized Businesses, all recruited on the basis that they were engaging in tax evasion, and critically that this evasion behaviour was deliberate rather than accidental.

- Recruited using attitudinal questions derived from the SME segmentation as a proxy for behaviour, supplemented with basic behavioural questions in relation to tax
- Validated through the interview itself, to ensure eligibility
- The resultant sample incorporated businesses engaged in a range of the following evasion types;
  - Understating turnover
  - Overstating costs
  - Understating employee earnings
- Mixed interviewing methodology, to suit respondent preferences and allow a greater geographic spread;
  - 20 interviews conducted face-to-face
  - 25 interviews conducted over the phone
- A mix of Small and Mid-Sized Businesses
  - 40 Small Businesses
  - 5 Mid-Sized Businesses

### 6.2 Sample breakdown

Owing to the challenges associated with recruiting among this hard-to-reach audience, no further quotas were fixed, but size, sector, age of business and region were also monitored to ensure a mix within the sample;

Business size (number of employees)	
0	10
1 – 9	27
10 – 19	5
20 – 49	2
50 - 99	0
100+	1
Turnover	



<£10m	43
£10m to <£200m	2

Sector	
Building and construction	5
Services	13
Education	2
Engineering and tech.	4
Leisure and hospitality	3
Manufacturing	5
Retail	13

Region	
North	21
Midlands	9
Southwest	3
London and Southeast	12