



Research report

Agents role in SME compliance

Qualitative Study

Business Customer Unit

Her Majesty's Revenue and Customs Research Report Number 127

*Behavioural Evidence and Insight Team
part of the HMRC Customer Units*

Agents role in SME Compliance

About the Business Customer Unit (BCU)

Business Customer Unit (BCU) is part of Business Tax responsible for ensuring businesses pay the right amount of tax whilst improving our customer's experience and the overall UK business environment.

The BCU role is to help colleagues make customer focus a reality by understanding our Business Customers needs better and using that understanding to design better products, processes and service delivery.

Contents

Research requirement (background to the project)	3
Who did the work (research agency)	3
When the research took place	3
Method, Data and Tools used, Sample	3
Main Findings	5

Agents role in SME Compliance

Research requirement (background to the project)

There were 5 key areas the research needed to explore:

- How does the Agent market work?
- What is the overall value (in the broadest sense) of Agents to SMEs?
- In what ways do Agents affect the SME compliance segment dimensions, and what is the effect of this impact (if any)?
- What impact do Agents have on HMRC costs (at least those that are generated by the customer, such as inbound contact), client costs, HMRC reputation, and satisfaction (if any)?
- What is the best way of understanding/ measuring Agent contribution to SME compliance?

Who did the work (research agency)

The research was conducted by Quadrangle.

When the research took place

The research was conducted between December 2009 and April 2010

Method, Data and Tools used, Sample

Phase 1: Knowledge Audit

- Review and re-analysis of existing segmentations with:
 - SMEs
 - Agents
 - Employers
- desk research
- 3rd party information
- Agents' forums (HMRC and non-HMRC)
- HMRC stakeholder consultations
- Development of 'golden questions'

Agents role in SME Compliance

Phase 2: Within Segment Research

- 26 depth interviews with SME's (lead financial decision-maker)
 - split by segments
 - 60-90 minutes each depth
- 25 depth interviews with Agents
 - client and HMRC-facing Agents
 - split by segments
 - 60-90 minutes each depth
- Focus groups with Agents, to discuss relationship with HMRC and influence on SMEs
 - 6 Agents at each, in London. 90mins
- Depths with Rep Bodies (ATT / ICAEW / CIOT / FSB)
 - 4 depths in total
 - 45 minutes each depth

Phase 3: SME and Agent pair / trio Research

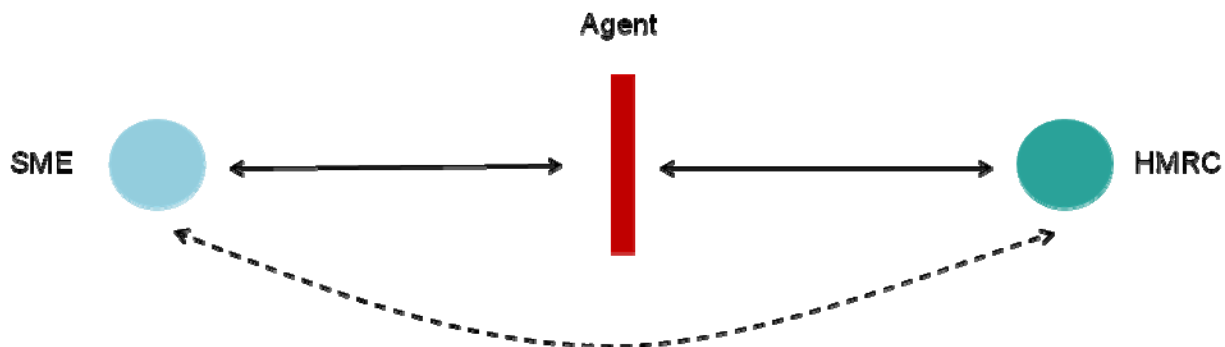
- 10 SME and Agent pair/triad depths to explore and understand priority aspects of relationship and the influence Agents have on SMEs
- 2-3 hours in length
- 8 pairs: owner/ financial decision-maker plus Agent
- 2 triads: owner and financial decision-maker plus Agent
- 'Trio' depths to explore issue of 'me' in SMEs – balancing the tax 'I' pay and the tax 'my company' pays

Agents role in SME Compliance

Main Findings

The SME – HMRC – Agent Relationship

As far as possible, both SMEs and their agents prefer to foster and maintain a 2 way relationship, minimising SME-HMRC contact:



The rationale for this dynamic from a SME perspective is to alleviate the ‘hassle’ of dealing with HMRC (considered to be time consuming, bureaucratic, confusing, and frustrating). Ultimately, they want the agent to act as a ‘barrier’ to HMRC, to keep them at arm’s length.

From an agent’s perspective, standing between their client and HMRC is also the preferred way of operating. The main reason being that SMEs are not seen to be properly equipped for direct contact which could result in them making mistakes or leaving the business (or agent) open to scrutiny. Smoothing over resulting HMRC queries leads to unnecessary time/ money lost.

However, whilst agents are highly efficient at dealing with HMRC, they also must accept that they can only control those elements of the tax structure they are involved in (whereas, for example, VAT is likely to be done in house).

In addition to the burden of dealing with HMRC, there are a variety of reasons that SMEs use Agents. One of the key reasons being fear:

- HMRC are seen as a draconian organisation, with large amounts of power that they can apply as and when they want, with severe consequences to businesses who don’t comply.
- Some SMEs feel that the complexity of the HMRC systems makes it hard to comply, without the help of an agent.

As such, some SMEs may take up the use of an agent through the desire to be, and be seen to be compliant.

Another key reason is that HMRC is also seen to be lacking in commercial intelligence:

- Since finance administration is not core business for most SMEs, the lack of commercial experience amongst HMRC staff is seen as a barrier to more effective relationships.

Agents role in SME Compliance

It should be noted that while recent contact with HMRC may be more positive than expected, this does not fuel any desire to have greater direct contact, or dispense with the services of an Agent.

In terms keeping up to date, despite the 2 way nature of the SME – HMRC – Agent relationship, both SMEs & Agents expect HMRC to send updates on major changes to both parties, with this being seen as a ‘two-way’ responsibility.

Either way, SMEs expect their Agent to inform them and action any required changes, their role being to understand and react. Whilst it is universally agreed, in theory, that it is the SME’s responsibility to keep up to date with policy changes, new saving opportunities etc., in reality, it has become a role generically carried out by the Agent.

Development of the SME – Agent Relationship

Recommendations play a central role when choosing an Agent, usually via word of mouth (recommendations from friends, family, business associates). A smaller proportion of SMEs conduct their own research to choose an agent.

Either way, the key issue is one of ‘trust’ – a general level of scepticism exists around the *practice* of accountancy and SMEs want to feel ‘peace of mind’ when striking up a relationship.

With the emphasis on recommendation, Agent marketing only really becomes relevant at the larger business end. Marketing is important for all Agents, but not the primary acquisition tool. It is most relevant as a means of attracting customers when Agents can call on the advantages of scale.

In terms of Agents choosing clients, whilst it is unusual for an Agent to leave a SME client, some businesses are viewed with scepticism (for example those involving high levels of cash transactions), and are avoided by Agents who are in a position to be choosy. However, the commercial pressures to bring in a continual stream of work often outweigh difficulties or anomalies with a ‘minority of clients’. Whilst choosing your clients is a desired state of affairs, it is often a luxury.

For both SMEs and Agents building – and maintaining – strong personal connections/ relationships is essential:

- **For the SME** – represents a belief that the Agent has the individual’s, and businesses’, best interests at heart, and that they won’t exploit the relationship in any way;
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- **For the Agent** – represents a belief that the SME will be open, communicative, and at all times legitimate in terms of disclosure of relevant business information and finance.

The Agent places particular emphasis on the early stages as this is where the seeds for long term success are sown – this can involve greater levels of contact and greater acceptance to swallow additional costs. However, this can create commercial issues long-term, as clients are quick to challenge cost increases and are unwilling to pay for services not previously paid for.

Agents role in SME Compliance

What builds a successful relationship

What the SME needs / wants from the Agent:

- To view their business as an important part of their portfolio, regardless of size;
- To show due care and attention;
- To provide proactive ways to minimise burden of tax, including tax liabilities;
- Develop efficient administrative processes;
- To make things simple and easy to understand;
- To provide protection from HMRC;
- To make them feel confident that everything is being managed efficiently and effectively;
- To demonstrate an understanding of their business and the world in which it operates;
- To offer sympathy when issues arise (e.g. compliance), and constructive, effective advice.

What the Agent needs/ wants from the SME:

- To remain organised e.g. keep good records;
- To listen to what the Agent says;
- To pay them promptly;
- To be measured, practical and rational in their opinions and decision making;
- To understand that they are working for them, not HMRC;
- To be honest and open when it comes to divulging relevant business practice and disclosure of earnings;
- To respond quickly to queries (from both Agent and HMRC), and to work within compliance timeframes;
- To be appreciative of the time and effort required to complete tasks (but not necessarily to understand what they do);
- To keep them informed of changes in the business.

The Agent is considered an essential part of running a business for most SMEs, providing a high importance service requiring specialist knowledge.

Tax is typically seen as a 'scary minefield'; hence SMEs are seeking someone to reduce the burden – provide 'peace of mind' and a sense of assurance and to give the business confidence. Essentially, the agent acts as an 'insurance policy'.

Re-assessing Agent needs and expectations happens throughout the relationship. SMEs change their Agent infrequently – long standing relationships are commonplace, although reviews more common in larger companies, who have greater expectations.

Key triggers for reviews are:

- seeking cheaper alternative;
- breakdown of relationship at personal level;
- sense Agent is not demonstrating the required level of interest/ attention;
- business growth/ development necessitates more advanced Agent.

Agents role in SME Compliance

At the smaller business level the seeking of cheaper alternatives is the key trigger, however, strong relationships built up over time often work against this. At the larger end, change is triggered by the desire for a more proactive and hungry Agent, one that promises a greater reduction in tax payments.

The commercial reality of the Agent world

Drivers of commercial success of Agents are clear in theory:

1. ability to charge out all the hours they spend:
2. ability to charge at the higher charge rates
3. ability to have a spread of work that can be undertaken by differing levels of staff

Small and medium SMEs afford greatest opportunity to do all three.

However, commercial reality is more complicated.

- As with SMEs some Agents are better business people than others
- They too have issues of acquiring and retaining business and how to price their services.

Role of the Agent in SME evasion, avoidance and (non)payment

There are two views of Compliance: SME and Agent.

1. SME definition of compliance:

- Complete and submit all necessary forms correctly and on time;
- Pay tax liability by the appropriate time.

For all but the least commercially minded sole trader and micro businesses, compliance is a recognised 'part of being in business' whether or not they feel meeting their tax obligations to be a onerous task or not.

There is also fear of a HMRC enquiry or investigation which works at both an emotional and rational level. On an emotional level it is the fear of being seen to have done something wrong, at worst criminal, even if unintentional. On a practical level it is the worry of accompanying cost and resource expense.

SME definition of non-compliance:

Not always complying is not always non-compliance in the eyes of SMEs. Things like late payment and errors are only regarded as 'non compliant' by the most attitudinally compliant and can be justified in certain circumstances by all SMEs. The option of Business Payment Support Services (BPSS) works to enhance this perception further. Occasional errors are not considered non-compliance and SMEs believe HMRC has legitimised correcting errors (cf. VAT process).

Agents role in SME Compliance

2. Agents' definition of compliance:

- Agents have the same *transactional* view of compliance as SMEs;

Agents consider most SMEs, especially at the smaller end, to be largely unaware of compliance issues. They feel their clients need to be chased for information and they don't always submit all the appropriate information (or in desirable format). This presents them with more work to ensure their clients are compliant.

Agents' definition of non-compliance

Agents also share the view that not adhering to these rules is not necessarily being 'non compliant', with once again errors and late payments the examples.

From both the SME and Agent perspectives the functional view of compliance is aligned, differences are more apparent when realistic avoidance opportunities become open to SMEs, but this is not at all common at the lower end of the SME space.

In terms of SME behaviour low scale tax evasion is a fact of life. SME tax avoidance involves amounts and transactions very much kept under the radar, and well out of sight of the Agent. Whilst Agents are aware that this situation occurs, there is often little they can do about it. Agents very much believe '*you can only work with what they have*' and are often reluctant to probe too deeply into their clients affairs.

An important learning is that small scale SME tax evasion is difficult to tackle via the Agent because Agents do not see their role to be enforcers. They recognise that some clients will not put all their cash through their books and most will at least highlight that this should not be done. However, there is no legal requirement for representation as long as they abide by their professional standards and the Money Laundering Act.

In terms of tax avoidance, the mantra of '*Evasion is illegal, avoidance is legal*' is delivered by both SMEs and Agents. However, avoidance in this context has a more general interpretation i.e. minimising your tax obligations within the rules e.g. pension provision, structuring the business to be more tax efficient. This is where SMEs and their Agents operate. Further avoidance measures and bending the rules is viewed more negatively and most would steer clear of these areas, although a few believe they are legitimate options until the avoidance scheme is made illegal

For SMEs, late or deferred payments are not seen as an option:

- Except in extreme situations;
- They accept they should pay their tax liability on time;
- Represents a business responsibility to have the required funds available.

However, others see deferred and late payment as more of a commercial decision:

- Cash flow and other issues may prevent them having the funds available;
- VAT and PAYE are the priority followed by SA and CT.

Agents are happy to promote recourse to payment deferral tools such as the Business Payment Support Service and see this as a legitimate tool in keeping a business afloat and 'compliant'.

Agents role in SME Compliance

The role of Agents in educating SMEs

The primary function of Agents is not to educate. However, the commercial imperative that drives Agent relationships with SMEs means they will educate if they can charge for it, or if they feel it will improve their ability to more efficiently service client relationships and enhance compliance (good record keeping is a key example of this). Many SMEs do not want to be 'educated' rather want to know they have got things right and what they need to do to ensure this. Over time this inevitably leads to education.

HMRC cannot influence what represented SMEs know and do. However, there is a spectrum of SME willingness and preparedness to learn, even on the most basic of financial management activities. Although few SMEs want educating per se on meeting their tax obligations; Agents act as the filter to, and informer of, what SMEs need to know and do to comply. Over time and influenced by client receptiveness they can encourage the good financial management activities that help underpin accurate and timely compliance

Agent Ability

As with most professions a blanket view of quality is unwise. Agent quality is evidently variable and this has a material impact on SME compliance for HMRC. For example, Agents have varying approaches to keeping up-to-date with legislative and other changes and to reconciling (possible) errors or income with personal outgoings etc.

There is a definite link between levels of service (and therefore costs) and the extent to which Agents will perform more than simple book-keeping, form completion and filing services for Sole Traders and micro-businesses.

Agents can have a positive or negative impact on SME compliance and whilst they will not readily admit to varying quality – including work done by juniors rather than qualified staff – it is apparent this is the case and does impact on overall compliance. In particular, low level fixed price work is often about 'getting onto the next one' rather than delivering high quality compliance work.

In summary

This work identified a number of potential areas for further exploration and highlighted the need for SME compliance to be addressed both directly – with the SME – and indirectly – through the Agent. The Agent as an influential channel to affect SME compliance in terms of errors and also avoidance/evasion is an area which could be exploited to achieve significant gains in terms of helping to close the SME tax gap.