

Qualitative follow up to the 2012 HMRC Compliance Perceptions Survey: Merchant Acquirers and Transparent Benchmarking

TNS BMRB report

HM Revenue and Customs Research Report 307

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Executive Summary

This research provided the qualitative follow-up to the 2012 Compliance Perception Survey, with 30 face to face depth interviews conducted with Small and Medium Enterprises (SMEs). The project explored trends emerging from the survey in more depth, as well as reactions to two new strategic areas: the introduction of Merchant Acquirers data as a tool for detection and deterrence; and the use of transparent benchmarking to assist compliance. The key research findings are summarised below.

SMEs' definition and perception of compliance remained unchanged since the previous year's research. SMEs defined 'doing the right thing' in relation to their tax affairs as paying the right amount of tax and paying on time, as well as keeping accurate, up-to-date records. The difference between compliance and non-compliance was not always so clear cut - respondents identified several 'grey' areas including expenses and gifts, and expressed interest in maximising the amount claimed back in this way. They regarded this practice as distinct from large businesses' perceived exploitation of grey areas through tax avoidance, which was considered morally unacceptable and perceived to require sophisticated accountancy and knowledge of tax law.

While SMEs identified factors they thought would impact on the likelihood of evasion, they struggled to gauge how common evasion was amongst businesses because evasion was little discussed amongst peers and seen to lack visibility in the press. Respondents tended to use rules of thumb to estimate what evasion levels might be, such as assuming 20% of all businesses evaded, rising to 50% for cash-based businesses. Cash-in-hand and complex manoeuvres were still perceived as the most widespread form of evasion. Complex manoeuvres were discussed almost exclusively in relation to tax avoidance among large international corporations.

Perceptions of compliance strategy

HMRC's strategy for detecting errors and evasion was largely a black box to respondents, though resourcing levels were broadly assumed to have decreased recently in the climate of government cuts. SMEs expected this had resulted in an overall reduction of evasion detections by HMRC, who would target resource to maximise the revenue they could collect. Respondents felt that SMEs, rather than micro or large businesses, would be the main focus of this new strategy, believing small and large businesses to largely fall outside HMRC's focus.

SMEs' perceptions of HMRC's compliance strategy were based on very limited information sources: media reports, communication or contact with HMRC. These few sources had a disproportionately strong impact on attitudes, with one experience or story having the potential to completely change an opinion of HMRC's ability, competence or firmness.

Respondents struggled to determine the level and likelihood of detection, but assumed detection levels would be fairly low, with estimates ranging from 5% to 30% of all evaders being caught. SMEs broadly expected HMRC's primary method for the detection of evasion to

be based on random inspections; despite their knowledge that intelligence-based mechanisms were in place to detect potential evasion.

Information held and used

Respondents generally held little knowledge of what information HMRC might hold about businesses. Responses varied according to the respondent's individual tax and IT literacy, with greater knowledge linked to higher scepticism about the level of data HMRC held. Returns data was the only information that respondents expected to be held as standard - that is, not during an investigation - and assumed some kind of automatic checking that could detect anomalies in the data submitted would be in place. Automatic checks were thought better suited to detecting errors, as respondents doubted that intentional evaders would submit data to HMRC with such obvious discrepancies.

SMEs commonly assumed that HMRC did not routinely access and match information about businesses beyond what they themselves submitted. Whilst SMEs with lower IT and tax literacy suspected that HMRC may be data-matching for all businesses, the prevalent view was that only specialist, targeted teams within HMRC would undertake this. Whilst it was not expected to be undertaken for every business, there was a strong perception that data matching would take place if HMRC had a reason to suspect a business of evasion.

Merchant Acquirers

During interviews, respondents were told that under new powers, HMRC would have access to the Merchant Acquirer data¹ for individual businesses, for monthly aggregated income. Respondents were unfazed to learn this, and thought it to be both unsurprising and reasonable. Respondents expected the *overall* impact of access to Merchant Acquirer information would be somewhat limited, as plastic data was considered easy for HMRC to collect and therefore not worth evading.

Respondents did identify some positive compliance benefits of Merchant Acquirer data. They saw the strategy as aimed at evaders rather than the compliant, and considered it an effective tool for detecting non-declaration or under-declaration of income. Respondents expected the most significant impact of this to be on online and retail businesses, given their heavy or exclusive reliance on credit and debit card transactions. They also expected messaging about HMRC's new powers may have a positive compliance impact on potential evaders, including the 'average' person that was evading or considering evading. SMEs did not think that the communication of Merchant Acquirers would cause more businesses to move to cash transactions, as they felt the use of credit and debit card was too widespread and well entrenched to change.

However, the compliance benefits of this data were not immediately clear to anyone but the few most financially informed respondents, and the majority required examples to explain how Merchant Acquirer data might be used to detect evasion. Respondents were unanimous in asserting that HMRC ought to be transparent with businesses about their access to this data.

Transparent benchmarking

¹ Merchant acquirers are the companies that process card payment transactions. Businesses need to be registered to one of these merchant acquirers in order to receive credit or debit card payments. Under new powers, HMRC will now receive information from the merchant acquirers. This will provide HMRC with details of all the transactions by debit and credit card paid to a business, i.e. through their card payment terminal or online. HMRC will not be receiving information specific to each transaction or specific to an individual – but rather aggregated data for the month, e.g. 300 transactions at a total of £5000 in January.

There was an expectation that HMRC made internal use of benchmarking data (or similar) in their compliance work. When the concept was introduced, respondents initially expected the published benchmark could be of commercial use if they could use it as a measure of their efficiency against other businesses. Once seen, however, the benchmarking communications did not provide enough detail to be considered useful to SMEs in this way. Respondents did not deem the information helpful for checking for errors in their tax returns, as their income and outgoing 'were what they were' and couldn't be altered to fit within a prescribed margin. On the whole, the benchmarking letters given to respondents were received either negatively or with indifference, for several reasons. Respondents felt they implied evasion rather than error; they struggled to see how they could be useful to businesses; and expected they would incur a time or cost burden, for example to consult their accountant. This was felt to be an unfair burden if HMRC had acknowledged a business may legitimately be outside the benchmark.

On reading the benchmarking letters, SMEs were unsure as to what their next steps should be, with most saying they would speak to their accountant in the first instance. Others said they would respond by reviewing their business practices, as they interpreted the information as an indication of poor business performance. Respondents who were more disengaged from HMRC, with limited past contact, expected they may dismiss the information as irrelevant and take no action.

Businesses that saw themselves as simple or quite typical of their sector were most likely to recognise the usefulness of benchmarking information. Factors affecting business perceptions of their comparability included geographic location and the size and scale of a business, amongst others. Respondents also pointed out that multiple undocumented factors existed that were largely unmeasurable, such as the efficiency of a team. Those in more niche sectors, who did not know of any other businesses like them, were less commercially interested in this data, as they did not consider the comparison to be valid. Whether a business believed they were comparable with others determined whether they felt the data was useful to their business or could improve compliance. This in turn influenced their perception of how fair it was for HMRC to compare them in this way.

1. Introduction

1.1 Research Background

The Compliance Perceptions Survey (CPS) measures perceptions of tax compliance among individuals and Small and Medium Sized Enterprises (SMEs). The overarching aim of this research is to measure perceptions of tax compliance among SMEs over time, in order to help HMRC understand: what drives compliance behaviour, and the deterrent effect of HMRC activity; and what impact policy and environmental changes have on SME perceptions over time. This research is the qualitative follow up to the 2012 survey. Early findings from the survey suggested that perceptions of compliance and evasion had remained fairly stable, so discussion recovering the general perceptions of compliance and evasion was comparatively brief. The research instead additionally focused on two new strategic areas. It explored SME responses to the introduction of Merchant Acquirers data as a tool for detection and deterrence, and the use of transparent benchmarking to assist compliance.

1.2 Aims and objectives

The key objectives of the research were to explore:

1. Interpretations of compliance and evasion
2. Perceptions of likelihood of detection for evasion and error
3. Perceptions of HMRC compliance strategy, including resourcing and effort
4. Merchant acquirers information and perceptions of what information HMRC holds
5. Benchmarking and potential impact on customer behaviour

1.3 Methodology

Face to face depth interviews were conducted with 30 SMEs, recruited from those in the survey sample who indicated that they were willing to be re-contacted. Interviews were conducted with the individual in the business that had completed the survey earlier in the year, being either the owner/manager or finance manager. Interviews lasted one hour, followed a topic guide and included stimulus provided by HMRC (see Appendix A). Researchers tailored the time spent on different topic areas to respondents' experience – therefore more time was spent discussing Merchant Acquirers among those taking credit/debit card payments, while smaller traders completing their own Self-Assessment (SA) discussed transparent benchmarking in more depth. All interviews were digitally recorded and transcribed, and analysed through matrix mapping. This robust analysis method allows researchers to draw out the diversity of opinions as well as identify common themes across interviews (see Appendix E for a more detailed description).

Fieldwork was conducted in the period 7th September – 4th October 2013.

1.3.1 Sampling and recruitment

Initially the following variables were intended to be included:

- Ability to take credit or debit card payments
- Annual turnover
- Sector
- Size (number of employees)
- Perception of whether HMRC's compliance approach had recently become more or less firm, or stayed the same
- Level of personal interaction with HMRC

However, after encountering a low success rate with the sample, the first two variables were prioritised. This ensured a minimum coverage of SMEs who could take credit/debit card payments, relevant to Merchant Acquirers, and good coverage of smaller businesses with a turnover of less than £50,000 per year, relevant to transparent benchmarking.

Table 1: Achieved against primary quotas

Sector	No of employees	Turnover	Other
Retail/wholesale/distribution: 5	Sole traders: 11	Under £50k: 8	Able to take credit cards: 14
Professional/business service: 12	2-9 employees: 11	Over £50k: 22	
Catering/leisure: 5	10+ employees: 6		
Motor trades/transport: 5			
Construction: 3			

A full sample breakdown is included in the appendix.

Throughout the report, quotes are anonymised and attributed in the following way – detailing sector, turnover, number of employees, and whether or not the business is able to take card payments (if not this is absent). For example:

“Quote” (Retail/distribution, £50-100k, Sole trader, Able to take card payments)

2. Interpretations of compliance and evasion

This section details SMEs' understanding of compliance and evasion, including any areas of ambiguity. As expected given the 2012 survey findings, a significant shift from the previous year's results was not observed and definitions of evasion had remained stable. Some new areas emerged in relation to expenses and allowances, probably due to the group interviewed comprising more sole traders and small businesses.

2.1 Definition of compliance

SMEs defined 'doing the right thing' in relation to their tax affairs as paying the right amount of tax and paying on time. Respondents also stressed the importance of keeping accurate, up-to-date records, not only in order to support compliance but also to reduce the level of stress related to running a business. Respondents summarised their various tax obligations as doing everything HMRC requests of businesses, and there was wide agreement that tax compliance was linked to personal morality. Respondents generally expected that their interpretation of compliance was the same as HMRC's insofar as they did what was asked of them. However, some SMEs noted a difference in that they felt HMRC was more concerned with absolute accuracy and the '*letter of the law*', whereas their own interpretation of doing the right thing would not be compromised if they were incorrect by a few pounds.

Evasion on the other hand was defined as a deliberate act with the intention of defrauding HMRC.

2.2 Grey areas

During the discussions it was clear that the difference between compliance and non-compliance was not always so clear cut; these 'grey' areas included expenses, gifts and other claimable costs.

That could be a bit of grey area, in times, especially when you're doing things like entertaining. Well, not necessarily entertaining but if you bought lunch for the blokes and they're out on site, you know, what is that deemed to be? Is that a benefit in kind or is it not? I know there is a certain allowance that you can have every- Well, it's a weekly or a monthly allowance and things like that. You know? Or a yearly allowance. But that kind of is a little bit of a grey area. (Construction, £500k-1million, 2-9 employees, Able to take card payments)

Businesses did not always have a clear idea of exactly what expenses could be claimed for, and therefore the accountant was often relied on to make a definitive call. This deferral of responsibility to accountants echoes the 2012 findings; respondents reiterated that accountants held a high degree of control, and to some extent responsibility for compliance. Here, whilst respondents were concerned to avoid non-compliance, there was greater interest in paying less tax overall by discovering new items that could be claimed for. Businesses did not deem this immoral, but simply part of running a business efficiently.

2.3 Evasion or avoidance?

Seeking to minimise tax paid in this manner was regarded as different to large businesses' perceived exploitation of grey areas through tax avoidance, which was considered morally unacceptable and perceived to require sophisticated accountancy and knowledge of tax law. Though respondents mostly struggled with the precise definitions of differences between tax evasion and avoidance, they reiterated the 2012 research findings that avoidance and evasion constituted moral equivalents. There was a perception that large businesses and corporations manipulated and exploited grey areas within tax laws in order to essentially evade tax within the law. Respondents expressed resentment towards this behaviour and distanced themselves from the possibility of being able to do the same.

"If I, for some reason, decide not to pay my corporation tax, or to only pay part of it or to mess it up, HMRC, I'm quite sure, will come down on me like a ton of bricks. I'm quite sure. Quite rightly. It annoys me to think that large corporations, from my perspective, seem to be getting away with [not doing the right thing]". (Retail, £100-250k, 2-9 employees)

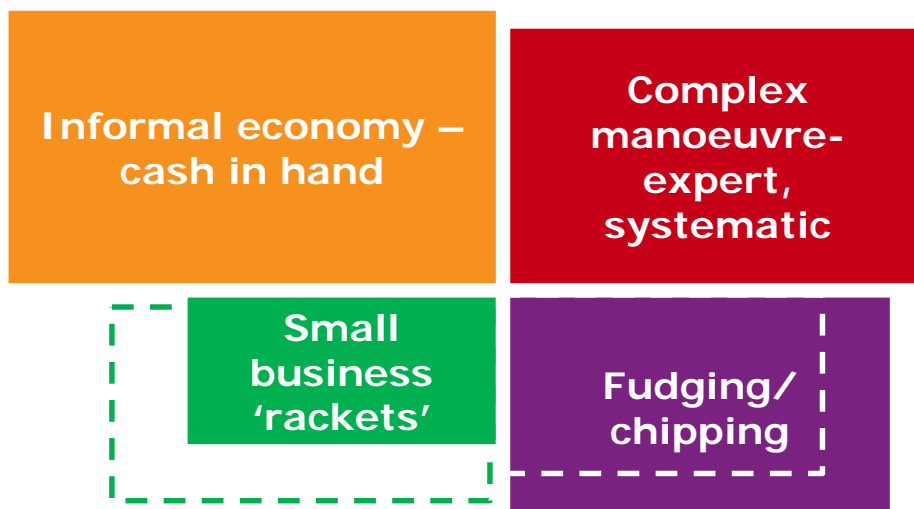
3. Types of evasion and prevalence

This section explores SMEs' perceptions of the prevalence of evasion, the likelihood of getting caught and the sources informing these views. It also explores the types of evasion SMEs regarded as most common, and compares these views with the typology of evasion produced in the previous CPS qualitative report to track any shifts in perceptions.

3.1 Typology of evaders

Respondents were asked about the types of businesses they thought were most likely to be evading tax. Respondents restated the four groups that made up the typology of evaders in the 2011 research:

Figure 1: Typology of evaders and changes since qualitative follow-up to the 2011 CPS quantitative survey. (note: dotted lines represent the proportion of these segments in the 2011 qualitative follow-up).



- Cash-in-hand – non-declaration of cash income. The informal cash economy was seen as the 'natural' place for endemic non-disclosure of income, and was assumed to provide significant opportunities to evade.
- Complex Manoeuvres – using sophisticated knowledge of the tax system and financial transactions to defraud. Perpetrators were assumed to be large, particularly multinational, companies with significant resources and financial expertise.
- Small business 'rackets' – temporary businesses with no intention of compliance, running on illegal grounds, rapidly opened and closed again.
- Fudging/chipping – activities most often practiced by businesses which were struggling or in decline. This was seen to include low-level attempts to reduce tax liabilities using cash, deferring payment to HMRC, or 'skimming' a proportion of tax declared.

Cash-in-hand and complex manoeuvres were still perceived as the most widespread form of evasion. Complex manoeuvres were discussed almost exclusively as tax avoidance by large international corporations. For cash-in-hand evasion, respondents included the rise of second jobs, part-time additional work and 'moonlighting', driven by economic hardship. There was a perception that these secondary income streams were most likely informal and difficult to trace, and unlikely to be declared to HMRC.

"...there's a lot of part-time drivers, so they've got a full-time job but they come at the weekend...and they'll literally work twenty-four hours a day...And because they've worked in a factory all their lives, theirs has already been paid through the PAYE system and so when they come on the taxis, it's an extra income that they're not declaring." (Motor trades/transport, £30-50k, Sole trader)

Cash in hand evasion, being based on cash transactions, was only assumed to be possible for public-facing businesses or traders. By contrast, businesses who did not deal with the public positioned themselves as necessarily outside this group and unable to evade in this way, suggesting that all their business to business dealings were traceable.

There was a shift from 2012 in how illegal business 'rackets' were conceived of, as it was not just small businesses that were expected to operate in this fashion. Whilst the small businesses that rapidly appeared and disappeared, such as road-side Christmas tree sellers, were still visible to SMEs, larger scale businesses were also believed to hold back funds from both suppliers and HMRC before purposively going into liquidation. Respondents cited the example of construction companies that emerged during the time of the London Olympics:

"Quite a few companies went down at the end of the year when they started getting all these creditors' and liquidators' reports and all that. I think they floated the companies mainly for Olympic Games, made their money and closed it down end of the year."
(Motor trades/transport, £1 million+, 50-249 employees)

Businesses regarded cash-in-hand evasion and business 'rackets' as largely belonging to the informal sector at the fringes of the economy, among criminal evaders who deliberately set out to defraud HMRC. By contrast, complex manoeuvres and fudging and chipping were seen to take place amongst more 'mainstream' or 'legitimate' businesses because avoidance was technically legal, and deferring was often assumed to be due to difficult circumstances forcing a business to delay, under-declare or pay later.

The fudging and chipping form of evasion was mentioned less often and generally in relation to delaying payments in response to cash-flow problems within a business. Though this was not discussed in as much detail as in the 2012 research, this suggests a shift in emphasis towards difficulty in paying tax and prioritising bills and paying suppliers, rather than a deliberate 'fudging' of figures to reduce tax paid. The perception of complex manoeuvres as fairly common remained stable, and respondents included large business tax avoidance within this group.

3.2 Other factors affecting evasion

Several factors were thought to have an effect on whether or not evasion was taking place.

Size of business: Respondents felt that as SMEs grew from small operations to companies paying the salaries of several members of staff, the pressure to be compliant (or conversely, the risks of being prosecuted and potentially going out of business) was far greater. This tied in to a perceived moral component to compliance, as employers would have a responsibility

not to run a business illegitimately and risk the jobs of their staff, as well as a perception that evaders were likely to be those with less to lose.

Customer behaviour: The current economic climate was expected to have had an impact not just on the likelihood of the number of businesses seeking to evade, but also on the number of customers likely to be complicit in this activity. Respondents expected that where members of the public were offered a lower price if they paid in cash, they were probably more likely to opt for this, in full knowledge of what it may entail.

However, other trends in customer behaviour were also expected to have an impact on evasion levels overall. SMEs expected that the general rise in the level of credit and debit card transactions would reduce evasion overall, as cash-in-hand transactions reduced and thus there was a reduction in opportunities for evasion. This was not deemed to be a conscious attempt to reduce evasion, but the result of a general shift in payment methods. This idea helped to shape responses to Merchant Acquirers information, explored in section 6.

3.3 Prevalence of evasion

It was difficult for respondents to gauge how common evasion was amongst businesses, for several reasons:

- little discussion of evasion amongst peers or professional contacts,
- little awareness of evasion having been reported in the press; and
- unless evasion was on a large scale or in a high profile case, it was perceived that it would not be reported in the media.

"You hear about large companies or people who get caught...in the newspaper, but it's usually something quite spectacular...they use a loophole or a grey area to their benefit, so, I mean, they're obviously getting caught...say it was a company like ours. We'd never be in the paper and nobody would know about it, so I don't know." (Professional/business, £50-100k, 2-9 employees)

There were some exceptions to this: for example in construction, where evasion was thought to be more common, there was more discussion about evasion and a greater knowledge of prosecution by HMRC within the industry.

Respondents tended to use rules of thumb to estimate what evasion levels might be, suggesting that in the absence of any concrete information they were resorting to heuristics. Respondents did not feel confident in their estimates and were quick to point out that they had little impression of evasion levels. Guesses tended towards around 20% of all businesses evading, though this figure rose to up to 50% for cash-based businesses.

"I'm coming from a stand point of complete ignorance here and I don't really know." (Retail/distribution, £50-100k, Sole trader, Able to take card payments)

The prevalence of error was also thought to be fairly high – with innocent error by businesses potentially fairly widespread.

4. Likelihood of detection: perceptions of HMRC's compliance strategy, including resourcing and effort

This section unpacks respondents' views about HMRC's compliance strategy, including whether they thought resource had increased or decreased recently and whether they thought HMRC's effort was at the right level. It then explores the information sources their views were based on, the effect of contact with HMRC on their views, and the perceived likelihood of detection. Overall, ideas about HMRC's strategy and resourcing framed SMEs' perceptions of the likelihood of evaders being caught.

4.1 HMRC's strategy

HMRC's strategy for detecting errors and evasion was largely a black box for respondents. Their only knowledge of specific methods for detection arose from direct experience of being brought up for investigation. Beyond these experiences, respondents found it very difficult to say how HMRC might go about this work.

There was a broad assumption that resourcing levels were likely to have decreased recently; a view influenced by multiple factors:

- HMRC was not expected to have been exempt from the recent climate of government departmental cuts, and the need to make cutbacks
- Standard VAT or PAYE inspections were perceived to be less frequent than before (by those who were used to receiving them)
- Respondents felt it was more difficult to get in contact with HMRC, which was backed up by anecdotal evidence from their accountants.

"Well that's just the general climate you know, we know that everybody's having cutbacks, Government Departments are having cutbacks so certain things will slip by."
(Motor trades/transport, £30-50k, Sole trader)

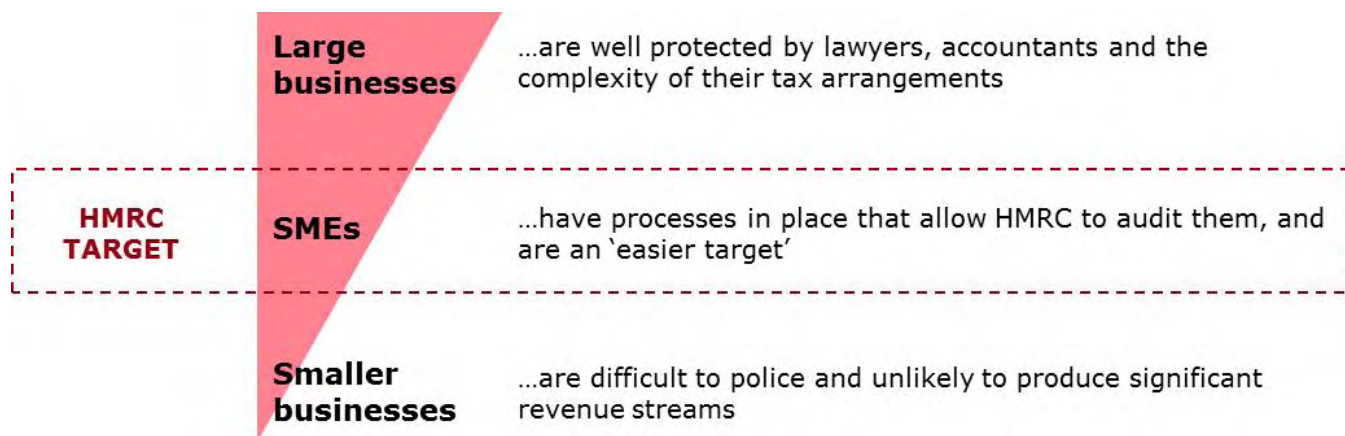
SMEs expected reduced resource impacts to be twofold. Firstly, the drop in staff numbers implied there would be less detection of evasion.

"I would imagine the HMRC is probably under-resourced and that means a lot of people get through. So I would think evasion would be pretty common and widely unpunished." (Professional/business, £500k-1million, 50-249 employees, Able to take card payments)

Secondly, they expected HMRC would focus their reduced resource to maximise the revenue they could collect. It was thought that HMRC would have to demonstrate return on investment at both a departmental and individual level, with HMRC only pursuing the groups and individual cases that they expected would be profitable.

Respondents felt that SMEs, rather than micro or large businesses, would be the main focus of this new strategy (see figure 2). SMEs saw themselves as the “low-hanging fruit” by comparison, as their rationalised reporting mechanisms and procedures made all of their activities easily visible and subject to interrogation by HMRC. This view was also driven by SMEs’ experience of tough penalties for late reporting, in contrast to assumed inaction by HMRC if a small scale evader was not reporting as meticulously.

Figure 2: Reasons for perceptions of HMRC’s targeting strategy



Very small and large businesses were thought to largely fall outside HMRC’s focus when compared to SMEs. At one end of the scale, it was assumed that evasion by very small businesses would be too diffusely dispersed to police, and potential revenue would be too small to be worth HMRC’s effort. At the opposite end of the scale, evasion amongst large businesses was thought too difficult to detect, pursue and prosecute. Respondents felt that even when large businesses were patently not paying the right amount of tax, the work that would be required from an expert team at HMRC, coupled with the high potential for failure, would play a part in HMRC’s decisions.

“I would think you could rationalise where you are going to get a reasonable pay back and I think that’s always been HMRC’s view...” (Professional/business, £50-100k, Sole trader)

4.2 Information sources

Respondents acknowledged that their views on how HMRC tackled evasion and set resourcing levels were based on tenuous sources and that they did not feel they knew what went on at HMRC. Seemingly contradictory views were expressed as a result of a lack of information about compliance strategy as well as a lack of contact with HMRC.

“I have no evidence either way. I suspect it is tougher. Although I don’t see or hear much evidence of inspections by HMRC ...I am not sure that HMRC have the manpower to police tax accounting, even as well as they used to. I mean we just have zero contact on that kind of level” (Professional, £500k - £1 million, 50-249 employees)

In the absence of substantive information or evidence about resourcing or prosecutions, the default assumption was that HMRC probably struggled to adequately resource compliance efforts. However, when respondents had encountered information about resourcing it did have an impact on their perceptions. The two main sources of information about this kind of activity

were media stories about HMRC's response to tax evasion, and the messages that HMRC put out about their own activity.

4.2.1 Media stories

Respondents paid attention to stories they heard in the media about tax evasion, avoidance and prosecution. There was fairly widespread awareness of news stories about large businesses, though interpretations of this were varied, and split according to the kind of story encountered. Stories about the prosecution of large businesses were interpreted either as evidence of a ramping up of HMRC's effort, or as a reflection of the media coverage characteristic of the political climate. On the whole, respondents were unconvinced that media reports about large business prosecutions were a reliable indicator of the overall levels of prosecution, though it was viewed as an indicator that some prosecutions were taking place.

I don't know, to be honest. I really don't know. You hear about large companies or people who get caught...in the newspaper, but it's usually something quite spectacular...so, I mean, they're obviously getting caught ... [but] say it was a company like ours. We'd never be in the paper and nobody would know about it, so I don't know. (Professional/business, £50-100k, 2-9 employees)

On the other hand, news stories about large scale tax *avoidance* in which businesses had not faced punitive consequences contributed to the perception that HMRC was more likely to be targeting SMEs as a result.

The idea that businesses would only hear about large scale or high profile cases was often reiterated by respondents. However, when local cases were seen in the press, the effect on perception of compliance strategy was significant – the interpretation being that HMRC was becoming both better at detection and firmer in their approach.

"I think they're clamping down on it a lot, because you hear it in the local paper now, there's a guy now, he's obviously a small business, a small like independent broker type thing, he's just been fined £2,500.00" (Motor trades/transport, £30-50k, Sole trader)

4.2.2 Contact with HMRC

Another source of information about HMRC's resourcing levels came from respondents' direct and indirect contact with HMRC. As mentioned in section 4.1, if respondents had experienced a decrease in the level of contact, either because they struggled to get through or were approached by HMRC less often, this resulted in a perception of dwindling resource. However, in instances where HMRC appeared proactive and knowledgeable, this gave the impression that HMRC was putting effort into compliance and had intelligence on businesses.

Case study: (Professional/business, £30-50k, Sole trader)

Respondent received letter from HMRC informing him they were aware of his move from self-employed to employed (working with the same firm), and to confirm that tax would only be need to be paid once. Their knowledge and fact that they were proactive in contacting him instilled confidence that HMRC 'knew what he was doing.'

SMEs were asked what their views about resourcing levels and compliance effort at HMRC were based on. Several individuals spontaneously mentioned advertising campaigns they believed HMRC to have run, or recollections of messaging about or from HMRC, mentioning both a campaign saying HMRC was targeting sole traders, and a message dissuading consumers to pay cash in hand.

"I think there was a bit of an advertising campaign a while back on the cash in hand tradesman type saying - I can't remember if it was just some features on the telly or whether there was some radio advert. But something sticks in my mind that there was a series of adverts or something by HMRC, saying you're not doing him a favour and all the rest of it, it's actually cheating the country out of tax income or whatever...It's just something that sticks in my head" (Retail/distribution, £250-500k, 2-9 employees, Able to take card payments)

Awareness of these or similar campaigns was vague and fairly limited amongst the group interviewed. Whilst it was difficult to measure the impact of awareness of these campaigns, it was significant that for some respondents they were the only reference these respondents could cite that related to resourcing or strategy at HMRC.

"What do I see from HMRC? The only thing I ever hear or see in terms of them trying to make people comply is the adverts on the telly, I hear them on the radio and things like that, so whether or not they're putting enough effort in, other than that I haven't really seen anything" (Catering/leisure, £100-250k, 10-49 employees, Able to take card payments)

4.3 Likelihood of detection

Respondents struggled to determine the level and likelihood of detection, again as prosecution was not heard of amongst professional or personal networks, or in the press. However, they assumed detection levels would be fairly low, with estimates ranging from 5% to 30% of all evaders being caught. Respondents attributed their estimates to relatively low awareness of prosecutions, and the level of resource at HMRC.

The predominant view was that there was a strong random element to detection; this view was driven by:

- the lack of awareness of HMRC's detection strategies, and an inability to imagine what they might consist of;
- the perception that resource at HMRC was low, meaning that their ability to conduct interventions with evaders was diminished; and
- respondents being told by HMRC staff that inspections are random.

"Well, we did actually have a guy- it was after our third VAT return. He did come in and as a new company he sort of said that we were randomly selected and he went through everything with us" (Professional/business, £50-100k, 2-9 employees)

One respondent believed so strongly in random inspections that they were prepared to assume that it explained their being investigated three times in three years, despite knowing there had been errors in returns due to poor record-keeping by a former member of staff. Though representative of a more extreme view, this was reflective of the strength and persistence of random inspections being central to detection.

Beyond this 'random' element, the relative likelihood of being caught was linked to several factors:

- the scale of evasion taking place, with smaller amounts seen as harder to detect;
- the subtlety and sophistication of the evasion method;
- the sector – industries known to be 'dodgy' were assumed likely to be targeted; and
- HMRC's perceived strategy of targeting SMEs (discussed above).

"My guess would be the ones in the middle get caught; the ones at the top-end don't because it's so complicated, and the ones at the bottom are too small".

(Professional/business, £30-50k, 2-9 employees)

At the individual/business level, respondents also identified a range of visual signals expected to trigger HMRC's suspicion and make them more likely to detect evasion. These included conspicuous discrepancies between lifestyle and declared income, an attitude or behaviour that appeared dishonest, or if a business was being run in a disorganised way. HMRC agents were expected to pick up on these signals, either by conducting inspections or even by going undercover and posing as clients or members of the public.

Discussion revealed that SMEs make several assumptions about HMRC's compliance strategy in the absence of detailed knowledge about it. It was envisaged to comprise a mixture of random inspections teamed with various sources of intelligence that may also trigger further investigation. These intelligence sources are explored in more detail in the next section.

5. Information HMRC holds on businesses

Respondents were asked about the kinds of information they thought HMRC had about businesses as standard. Following spontaneous responses, respondents were probed with specific examples and asked to imagine how HMRC might use this information to detect errors or evasion. Finally, respondents were asked what they thought the possibilities were for bringing these bits of information together about a business, and how credible they thought this was in practice.

5.1 Tax and IT literacy

Whilst respondents generally had very little knowledge of what information might be held, their responses about credibility of data matching differed according to their IT and tax literacy – which were an approximate proxy for one another. This variation in literacy also impacted on the sophistication of responses to the wider issues discussed, as those with higher tax literacy were better able to imagine how HMRC might use data and why it might be useful. Examples of opinions held by those in both groups are represented in table 2, below.

Table 2: Respondent tax and IT literacy

SME Type	Perception of information HMRC holds
Less engaged – little confidence or awareness of tax Heavy reliance on accountant Less IT literate	Unsure of data matching capability. Perceive that there is a lot of data 'out there' in the digital age, that businesses and government probably have access to it and are likely to be using it
More engaged, higher IT and tax literacy. May have accountant but takes more responsibility for tax affairs, familiarity with figures More IT literate	Most likely only returns are checked. Matching as less credible, given how difficult it is If data mining is done, it would require a small core team at HMRC to target resources

"As a Government department I'm sure that they have access to quite a lot of information, I mean you can't move nowadays without having some information covered on you." (Motor trades/transport, £30-50k, Sole trader)

“Realistically the information that the Revenue get is probably unusable. In my experience, well if you get composite figures they’re very difficult to interpret.”
(Professional/business, £50-100k, Sole trader)

5.2 Information held

Information that respondents expected to be held as standard by HMRC (that is, not during an investigation), was generally **limited to returns data only**. Respondents knew, often from experience, that in the event of an audit or investigation HMRC had almost unlimited powers and could access any information they wanted, including bank accounts and personal information. However, in general it was thought that HMRC would always need a reason to access more information than businesses submitted to them, but would not collect it as standard. This was partly due to data security reasons, as bank account information and other data was deemed personal or sensitive, but more importantly, it was thought too resource-intensive to systematically collect this data.

When prompted with some hypothetical examples² of data that might be held by HMRC, responses varied according to the respondent’s individual tax and IT literacy, with greater knowledge leading to increased levels of scepticism:

Individual salary payments: Respondents assumed HMRC held this information as it was submitted through PAYE, though some were sceptical that HMRC could cross-reference this with other information the business submitted. Respondents with less experience dealing with tax found the distinction between PAYE and other submissions confusing, consequently believing it all to be part of a single system. However, this would not necessarily stop a business from still paying part or all of their salary off records (i.e. cash in hand), with no information reported to HMRC.

Government contracts: Respondents were unsure whether HMRC had this data. It was deemed possible on the basis this information was publicly available, but deemed unlikely to be collected as standard practice for all businesses, as respondents imagined it would have to be retrieved on an individual basis.

Property transactions: If declared directly to HMRC, this data was assumed available, for example through the Land Registry. If a property was registered it was assumed to be more visible to HMRC. Stamp duty paid on a property was also assumed visible, though not automatically linked to a business, and that it would require some cross-departmental checking.

Lettings income: This was assumed visible only if directly declared to HMRC as part of business income, as it would not go through Land Registry. However, it was thought that HMRC could possibly detect the evasion of lettings income by following up on advertisements for property rentals. It was also thought that HMRC may check End of Year (EOY) returns for those who owned property and were paying high rates, but were reporting relatively low income.

Credit and debit card transaction data: The majority of respondents felt this was unlikely to be collected automatically. This is explored in greater detail in section 6.

² Respondents were not informed which of these hypothetical examples were true and which were false.

Bank accounts: Respondents did not think that HMRC had access to business or personal bank accounts, although as with all information they firmly believed this could be accessed if HMRC had reason to suspect wrongdoing. Respondents were sensitive to the idea of HMRC being able to routinely access bank accounts.

5.3 How this data is used

Most respondents struggled to say how HMRC might use this information to detect evasion. Their considerations were based on the information they thought HMRC had routine access to, that is, mainly limited to returns data. The following two sections briefly discuss how respondents thought HMRC might use returns data to detect evasion or errors.

It was assumed there would be some kind of automatic checking that could detect anomalies in the data submitted.

"...the figures we send must go into some sort of big central computer which must...be able to chuck things out and say, 'this isn't right, this needs further investigation.'"
(Catering/leisure, £50-100k, 2-9 employees, Able to take card payments)

This system was assumed capable of conducting various checks in order to detect errors or potential evasion, including flagging up:

- Sudden fluctuations in the amount of tax paid, such as VAT. This had prompted investigation of some respondents, who saw it as a trigger for HMRC, though it was acknowledged that these fluctuations could occur for legitimate reasons.
- Anomalies based on standardised formulae that would throw up discrepancies in ratios on likely profits for the industry against tax paid.
- Late payments; thought to be an indicator of either withholding tax, cash flow problems, or a level of disorganisation that suggested a business was being poorly run.

"...for example, if you had a massive VAT claim and your turnover was very small, relatively speaking, and you employed ten people; things would look strange. So, I suspect they can look at what the company profile is relative to its accounts or VAT submission, and [then] they will see things that look anomalous." (Catering/leisure, £100-250k, 10-49 employees, Able to take card payments)

"One presumes they've gone out and analysed different businesses and modelled them and then apply a model on a computer basis. So if you've got a baker's making 1% profit, there's something wrong... He's either going bust, a bad baker or he's fiddling the money." (Professional services, £50-100k, 2-9 employees, Takes card payments)

5.4 Errors or evasion?

When asked directly, respondents said they assumed HMRC detected errors and evasion in the same way. However, this response again demonstrated that specific detection methods had not previously been considered in any depth. Whilst knee-jerk responses were that HMRC had one catch-all approach, more specific discussion of evasion strategies elicited beliefs about how HMRC may distinguish between evasion and errors.

Further discussion revealed that the automatic checks discussed above were thought better suited to detecting errors, as respondents expected those who were purposively evading tax would not submit data to HMRC with such obvious discrepancies. Respondents also suggested HMRC could detect errors by comparing submissions within sectors, as they could see common

mistakes being made within certain kinds of business. As such, returns data on its own was not thought to be particularly effective for detecting evasion.

"I think people who are evading tax are much better at it than that. I don't think HMRC would spot them unless they actually went in and did a proper investigation. I don't think that they would spot it just by trends." (Retail/Wholesale/Distribution, £100-£500k, 2-9 employees, Takes card payments)

5.5 Data matching

This section covers a broader discussion of how HMRC might use other bits of data about a business, and the credibility of data matching in this context. The concept of data matching was introduced as bringing different bits of information about a business together. Respondents thought this would be possible and would help HMRC get a clearer picture on a business, but imagined that the process of data matching would be largely 'manual' - that is, though done electronically, requiring an individual to seek out various data strands and match them together, one business at a time. A further reason data matching was expected to be resource intensive stemmed from respondents knowledge of difficulties other government departments have had in setting up new IT systems that can link lots of different information, such as the NHS. In addition to being thought of as difficult and expensive to resource, it was expected that it would require a great deal of time and investment up front to put such systems in place.

"Historically, the government hasn't been very good at putting IT systems together" (Professional/business, £30-50k, 2-9 employees)

As with the kinds of information believed to be held, perceptions of data matching depended on a respondent's level of IT literacy. Those with lower IT knowledge and experience claimed to have little idea about what took place at HMRC, they had high expectations about their digital capabilities. The perception that HMRC 'knew everything' and could 'do anything' could become destabilised however, after a bad experience of contacting HMRC, or when digital systems failed.

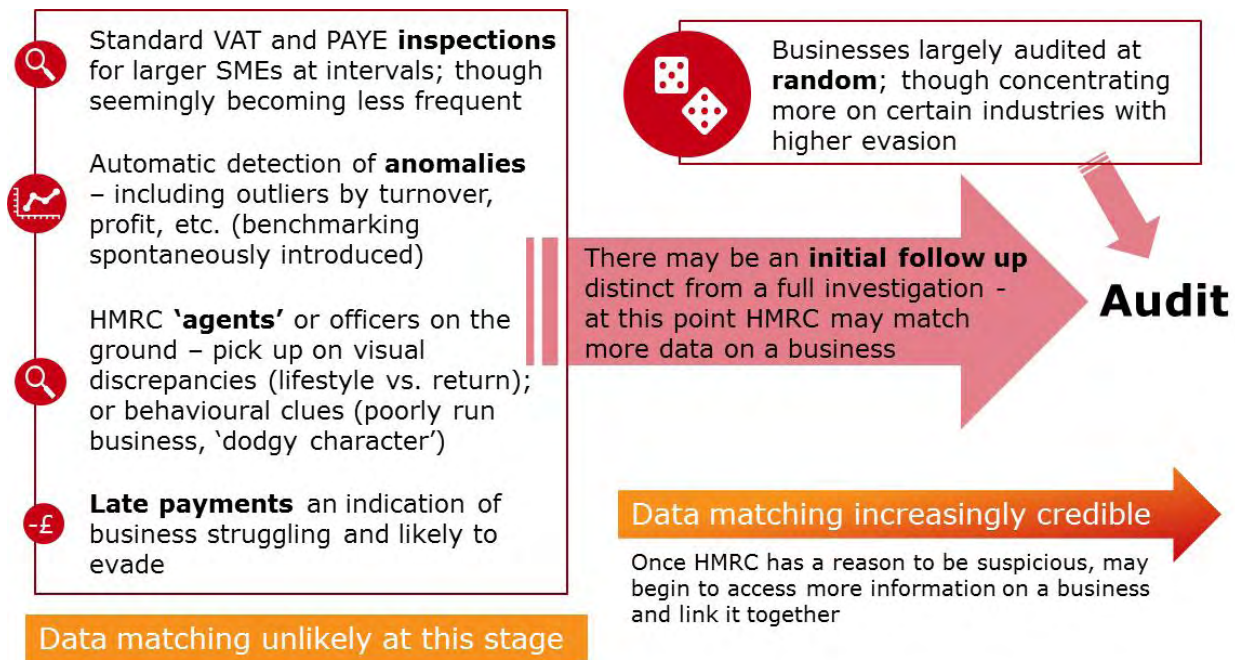
"Well, I did, until we had somebody from the VAT department come in... I thought they have these fantastic resources and they're very modern and very kind of up to date, because that's actually how they present themselves. It turns out they're not. You can't email them; you have to phone them and you have to post things to them. And HMRC doesn't talk to the VAT office or the VAT guys and vice versa, and that was actually quite disappointing." (Professional services, £50-100k, 2-9 employees)

Although those with lower IT and tax literacy ascribed greater credibility to HMRC's ability to data match overall, including their ability to share data internally, some of this group remained sceptical about cross-departmental data sharing. Being somewhat disengaged with HMRC and having had little contact with them, these respondents did not view HMRC as being joined up with other government services, perceiving them to be in some ways outside of government. These respondents were largely those who deferred all tax responsibility to their accountant; often because they did not themselves feel knowledgeable or confident enough to deal with their tax themselves. Those with higher levels of engagement with tax and greater IT literacy also tended to think that cross-departmental data matching was unrealistic in practice, due to a perception that government departments do not exchange data regularly or easily. This was

either based on experience of working with government departments such as DWP or local councils, or from media sources.

Despite the challenges associated with data matching, there was a strong perception that it could and would take place if HMRC had a reason to suspect a business of evasion, and required further information. Whilst it would almost certainly be a feature of any audit, it was also thought to be a likely way of conducting initial checks on a business before a full investigation was launched. Respondents identified a range of indicators of suspicion that could trigger this interim investigative process, in which some data matching could be taking place. These are set out in figure 3 below:

Figure 3: Perceived triggers leading to investigation by HMRC



5.6 Contradictory views

Through discussion of this topic, respondents often revealed contradictory or conflicting beliefs. Explicit discussion of information HMRC held and their ability to match data elicited scepticism about HMRC's capabilities. However, unpicking earlier discussion about possible methods for evasion, and the reasons preventing respondents from evading themselves, revealed several contradictions. For example, when asked how HMRC might detect evasion, respondents suggested they used a formula to check whether the proportions of cash and plastic income fit within an average ratio for a similar business. However, when asked later about what information they thought HMRC held about businesses, only returns data seemed plausible, despite the fact that the cash/plastic breakdown would not be included in this submission. Another example lies in one respondent's expectation that HMRC could check business to business transactions to detect evasion, which was put forward as a reason evasion would be impossible in her business. In later discussion however the respondent echoed the broad view that HMRC only had routine access to returns data for a business, which again would not include a breakdown of individual business transactions.

On the one hand there was an expectation that HMRC knew certain things about businesses, yet on the other there was a belief that HMRC did not have routine access to the same

information. This tension between HMRC seeming to know things despite not being believed to have the necessary data can be explained in two ways. Firstly, as these issues had not been given serious consideration before, it is somewhat unsurprising that conflicting opinions had not been reconciled. Further, respondents assumed that certain kinds of data would be so easy for HMRC to obtain that in a sense they were effectively already available, despite not actually being collected. Anything that was automatically, electronically recorded fell within this category. This transparency, or ease of traceability, was seen to make these transactions almost impossible to evade undetected, and the transparency acted as a deterrent – though it should be noted this research was conducted amongst a broadly compliant group. This link between the accessibility/traceability of data and the likelihood of detection is strong, and frames the way the respondents understood the Merchant Acquirers information, discussed in section 6.

"I think actually it is fair. ...If you're using your merchant account, you've got another person there anyway, so, in terms of...evasion and things like that, if you're stupid enough not to be giving that information freely to HMRC then I think you're likely to get caught because there is a paper trail anyway, so they might as well go direct to the source there, which I know does counter what I said about bank accounts"
(Professional/business, £50-100k, 2-9 employees)

5.7 Implications

SMEs' perceptions of HMRC's compliance strategy were based on very limited information sources – in media reports or in HMRC communications - or on one or two experiences of contact with HMRC. These few sources had a disproportionate impact on attitudes, with one experience or one story having the potential to completely change someone's opinion of HMRC's ability, competence or firmness. This means that perceptions were highly subject to potential volatility.

SMEs broadly expected that HMRC's primary method for the detection of evasion was based on random inspections. This view existed alongside the knowledge that intelligence-based mechanisms were in place to detect potential evasion. It also persisted despite the fact that SMEs expected HMRC had a compliance strategy in place, which involved targeting SMEs and certain industries that were likely to evade.

The view that HMRC did not routinely access and match information about businesses beyond what they themselves submitted was pervasive. Whilst SMEs with lower IT and tax literacy suspected that HMRC may be data-matching for all businesses, the prevalent view was that this did not take place as standard but would need to be in specialist, targeted teams within HMRC.

6. Merchant Acquirers information

Respondents were told that under new powers, HMRC would have access to the Merchant Acquirer data³ for individual businesses, for monthly aggregated income. Reactions to this information were fully explored, and respondents were asked how they thought HMRC could use the data, whether they thought the collection of this data was fair and appropriate, and what they thought the impacts might be on businesses.

6.1 Factors affecting views

It should be noted that responses to this information were again affected by the typology outlined in table 2. Those who were less financially and technically confident supported the idea of HMRC's use of Merchant Acquirers data to detect evasion, and those on the other end of the scale expressed scepticism about the efficacy of this practice. A further influence on reactions to this information lay in the nature of the respondent group. Respondents were broadly compliant and had not previously considered how one might evade through credit and debit card transactions. This impacted on their perceptions of what was possible. Related to this, and as discussed in previous sections, respondents perceived data that was easily traceable to be almost impossible to evade successfully. This reduced the perceived impact of HMRC gaining this information on compliance.

6.2 Initial reaction

Respondents were unfazed to learn about information powers that require Merchant Acquirers to supply businesses' aggregated card transactional data to HMRC. While not all had thought credit or debit transaction data was already available to HMRC (see section 5.3), it was thought both unsurprising and reasonable - a legitimate means to detect evasion.

"I don't have a problem with it... I think it is fair enough but, you know, it's just again one more piece of information; one more piece of data; how are they going to be able to process that; what is it going to give them?" (Professional/business, £30-50k, Sole trader)

With the exception of a few financially knowledgeable respondents however, the compliance benefits of this data were not immediately clear, and the majority required the case study examples to contextualise how this might be used to detect evasion. Once examples were offered about the types of fraud this could detect, respondents were able to grasp how Merchant Acquirers might be useful to HMRC.

³ Merchant acquirers are the companies that process card payment transactions. Businesses need to be registered to one of these merchant acquirers in order to receive credit or debit card payments. Under new powers, HMRC will now receive information from the merchant acquirers. This will provide HMRC with details of all the transactions by debit and credit card paid to a business, i.e. through their card payment terminal or online. HMRC will not be receiving information specific to each transaction or specific to an individual – but rather aggregated data for the month, e.g. 300 transactions at a total of £5000 in January.

Case Study 1

The data that HMRC received has identified a dry cleaner that over the last year has received £100K of sales where the payment method was debit / credit card. HMRC has not been able to identify any tax record for this business.

Case Study 2

The data that HMRC received identifies a florist that has more than one account for processing their debit – credit cards sales. When HMRC add these together the total for a year comes to £250K. The business is registered for tax. For the same period they declared a total turnover of £210K.

Amongst a broadly compliant group, the respondents interviewed had struggled to come up with methods of potential evasion, and expressed surprise that other SMEs would attempt to evade in the ways depicted in the case studies. This was particularly pronounced for Case Study 1, which respondents viewed as deliberately criminal behaviour, inhabiting the informal sector and exemplifying 'out and out evasion' (see section 2.1). Respondents were encouraged and pleased that Merchant Acquirers data would be able to detect this kind of criminal activity.

"I suppose that's what I hadn't considered, that you would be so stupid as to take £100000 through a credit card terminal and think that you could not declare any of it, but I guess there probably are people" (Retail/distribution, £250-500k, 2-9 employees, Able to take card payments)

Case Study 2 was categorised as the 'fudging/chipping' type of evasion. Respondents considered it to be more ambiguous than the first case study, as it suggested possible error rather than deliberate evasion. This example also made respondents more positive about the benefits of Merchant Acquirers for detecting undeclared income.

Following discussion of the case studies, SMEs understood the strategy to be aimed at evaders rather than the compliant.

SMEs were asked about how they thought Merchant Acquirer data would be used. Respondents with less tax and financial experience were more positive about the ease of using Merchant Acquirer data, though remained vague about how this would work in practice.

"I'm sure someone with more skills than myself could gather that data and apply it, and use it for the correct benefits". (Construction, £30-50k, Sole trader)

Again, those more engaged with IT and 'big data' expected that making use of Merchant Acquirer information could be complicated, and would require considerable resource at HMRC.

"My spontaneous thoughts are that it's likely to frighten many tax payers into better compliance but that actually, realistically the information that the revenue get is probably unusable. In my experience, well if you get composite figures they're very difficult to interpret." (Professional/business, £50-100k, Sole trader)

"The issue they have is the phenomenal amounts of data they're dealing with you know you're dealing with millions and possibly billions of transactions."
(Professional/business, £30-50k, 2-9 employees)

6.3 Likely impact on compliance

Respondents had mixed views about whether Merchant Acquirer data would have a significant effect on compliance levels. This was partly due to how SMEs conceived of plastic transactions and plastic data. As mentioned in section 2, the use of credit and debit cards was thought to have a positive effect on compliance, as it was considered very hard to evade. The fact that plastic transactions left an electronic record that could not be easily altered contributed to the perception that this forced businesses to be compliant, at least in this aspect of their activity. Given the strong link between the traceability of data and the likelihood of detection, respondents felt that in some respects HMRC already had this data, as it could be so easily requested. As these views were widely shared amongst respondents, the *overall* impact of access to Merchant Acquirer information was expected to be somewhat limited, given the strength of the perception that plastic data was not worth evading. As respondents themselves could not see how to evade through credit or debit cards, and because it was considered so easily traceable, respondents expected evaders to be put off.

"I think anything that leaves a paper trail, the tax evaders know it's going to leave a paper trail so they won't do that." (Retail/distribution, £100-250k, 2-9 employees, Able to take card payments)

"I think if your intent is to evade from the outset then you will avoid the use of card machines and you just will not take receipts." (Catering/leisure, £500k-£1 million, 500-249 employees, Takes card payments)

Further, rather than representing a step-change providing HMRC with new information, access to Merchant Acquirers data was seen as a shift to slightly 'cleaner' data, accessed automatically 'from source' rather than having to be requested from a business. Whilst the data had become slightly easier for HMRC to access, in that it was quickly and automatically available, it was effectively perceived as data that was already fairly clear-cut, accurate and fairly easy to acquire. Respondents' limited expectations about the impact on compliance thus also stemmed from the fact that Merchant Acquirers was only providing a slightly clearer picture, but still did not provide the 'whole picture' for all of a business' activities.

Whilst these views about the overall limitations of the impact of Merchant Acquirers were widely held, respondents could also discern some positive compliance benefits. These pertained to certain types of businesses or types of evaders - that is, the type of person they would expect would take the risk and try to evade through credit/debit card transactions. Respondents saw the strategy as targeting the 'black' economy, expecting that the most significant impact of the scheme would be to identify businesses that were not registered for tax and not declaring any of their income⁴. They also expected the most significant impact to be on online businesses who dealt exclusively in credit and debit card transactions. Respondents suggested that businesses may be discouraged from paying the full amount of tax if it meant they became financially unviable, particularly for micro-businesses such as hobby-crafts run online.

"I'm not entirely convinced it would make a big amount of difference to most regular businesses like ours or high street shop. I would imagine it would make a serious amount of difference in the post-Amazon world and the people who haven't really declared that they're trading at all." (Professional/business, £500k-1million, 10-49 employees)

⁴ This example is provided in the case studies – see appendix A. Very few respondents were able to identify this method of evasion without the case study example.

It was also thought to have more of an impact on retail businesses, or indeed any business that was predominantly credit/debit card based.

"It would bring the whole retail community into a much higher level of visibility."
(Professional/business, £30-50k, 2-9 employees)

It was thought that these types of evasion could be detected without the communication of HMRC's new powers. However, SMEs did see communication from HMRC about Merchant Acquirers as a deterrent for potential evaders, who had not yet acted but might decide not to evade as a result of messaging. Respondents expected messaging could also have a positive compliance impact on the 'average' person that was evading or considering evading. Here, they referred to the 'fudging/chipping' behaviour of businesses that did not use sophisticated techniques to evade, but may under-declare or skim small amounts from declared income.

"It'll only have an impact on those who were doing a fiddle job somehow...I imagine there is an issue for a small few cash businesses who think, oh I didn't know that, and I wasn't going to declare that income." (Professional/business, £1million+, 10-49 employees, Able to take card payments)

Respondents identified one potential impact of communicating the Merchant Acquirers strategy as businesses being encouraged to take more cash or move to cash only businesses. However, given the ubiquity of plastic use among consumers this was deemed unlikely, as it was thought businesses could lose custom if they did not accept card payments. It was also thought that businesses would potentially flag themselves for investigation if they only accepted cash or suddenly stopped accepting card payments. Instead, respondents expected businesses would be forced to be more compliant as electronic payment became increasingly unavoidable, as consumers increasingly take the ability to pay by card for granted.

"I think we're probably moving towards a cashless society and you know you're probably going to be making payments more and more on your mobile devices and that keeps it all relatively straightforward and regular, if you like." (Catering/leisure, £500k-1million, 10-49 employees, Able to take card payments)

6.4 Data privacy and data security

Publicising Merchant Acquirers was thought not only to be effective in deterring evasion but was also central to ensuring transparency. When asked whether HMRC should tell businesses that they had access to this information, respondents were unanimous in asserting that HMRC ought to be transparent with businesses about their access to this data. Many used the analogy of the requirement to tell people if they were being filmed or on CCTV.

"I think [so] yes, because people like to know about stuff like that and some will complain. There will be a discussion about how much information government has and stuff like that." (Professional/business, £30-50k, Sole trader)

"I think morally they should just say we have access to this information."
(Professional/business, £1million+, 10-49 employees, Able to take card payments)

There was some concern expressed about the privacy of the data, spontaneously expressed by a significant minority of respondents. Particularly for small businesses and sole traders who did not take card payments and only used cards for purchasing, the use of credit cards for personal and business use was somewhat blurred. They were consequently suspicious that Merchant Acquirer data would include personal and purchase transactions. This view persisted

even where researchers stressed that only income data would be available. As a result a small minority of respondents continued to express discomfort (even after researcher reassurance) with what they considered an unnecessary increase in government surveillance, in which HMRC looked at them personally. By contrast, some respondents had the personal view that this should not be an issue if there was proof that it would have a strong compliance benefit, as overall benefit to the taxpayer for them should outweigh the loss of personal privacy.

"I think if they have that power to do it then it should be expressed and everybody should understand they've got power and under what circumstances they would use those powers and what safeguards there are...It's difficult to argue against, because if you've got a solid argument that says look this actually safeguards UK business and... safeguards the taxpaying public." (Professional/business, £50-100k, Sole trader)

For others, there was some concern about data *security* and the fear that (potentially commercially sensitive) data could be lost or leaked. This view stemmed from awareness of other government data leaks, and in reference to increased public awareness of computer hacking.

6.5 Reactions to 'Getting affairs in order' campaigns

Many respondents felt these campaigns⁵ to be fair for those businesses who had 'lost their way' – essentially the fudging and chipping group who had begun to evade in response to economic hardship but were not deemed to be 'criminals'. For this group the campaigns were labelled a kind of 'amnesty' campaign, and were viewed not only as a way to prevent struggling businesses 'spiralling out of control', but also as a way to increase the overall number of compliant businesses. Respondents thought it would be a good idea to time the announcement of the campaign alongside messaging about Merchant Acquirers to maximise its effectiveness. It was also lauded as a modern approach to be taken by HMRC. A minority of respondents had either heard of similar campaigns in the past or suspected that HMRC ran a permanent amnesty campaign, without publicising it.

"It just makes plain good sense to make it easy for people who have got themselves into a bit of a hole" (Professional/business, £500k-1million, 50-249 employees, Able to take card payments)

"...so they're not genuinely dishonest, well no they are genuinely dishonest, but they're not meaning to defraud they just cannot pay the tax and they might think that's an easy option...it's meeting people halfway, it's a good thing" (Motor trades/transport, £500k-1million, 10-49 employees)

Some SMEs stressed that it should only be offered once to a business, as otherwise it could create a 'soft-touch' image of HMRC. A small minority of respondents felt that such campaigns were unfair to those who had always been compliant, though did not feel strongly about it.

6.6 Implications

HMRC's access to Merchant Acquirer data appeared unlikely to have a significant impact on how businesses viewed HMRC, provided they were reassured about the security of the data, and the way in which it would be used. HMRC would also need to demonstrate IT capability

⁵ Explanation of these campaigns as provided to respondents: "HMRC sometimes runs campaigns that offer people a chance to get their tax affairs in order on the best possible terms. If someone has underpaid tax and they want to declare all their income voluntarily and set the record straight, they can make a report to HMRC and pay the tax. This means that they avoid the risk that they will be investigated and prosecuted."

and competence in relation to this activity, as some SMEs remained sceptical about HMRC's ability to data mine and match without a lot of resource.

Given broadly compliant businesses struggled to imagine how Merchant Acquirer data might be used to tackle evasion, the expected compliance benefits appeared minimal without some contextualisation or illustration of how this data was being used to detect evasion. The perception that a Merchant Acquirers strategy would not improve compliance also stemmed from the perception that plastic data was already fairly black and white, and transparent to HMRC.

7. Benchmarking and potential impact on customer behaviour

Businesses were asked whether they had a sense of where they sat against others within their industry in terms of turnover and tax paid, and whether this information would be useful to them in any way, including in checking the accuracy of their returns. Following this discussion, the concept of transparent benchmarking was introduced as a method of detecting evasion and two example letters were shown to respondents. The first explained benchmarking, prior to the completion of the ITSA, and the second stated that a business was outside the benchmark, having submitted the ITSA. Respondents were asked what they thought their likely response would be to receiving these letters, in terms of who they would contact to seek more information, whether they would check their returns, and their feelings towards HMRC.

7.1 Initial thoughts on benchmarking

Initial discussion about benchmarking remained fairly abstract, as respondents were not given much detail about what the information would entail or how it would be communicated. Respondents had high hopes about what it might offer them and how detailed it would be.

Respondents first assumed it would be primarily of commercial interest, in discussing how this information might be useful to businesses themselves. They expected benchmarking information to be fairly detailed, allowing them to see where they sat alongside competitors and use it to measure the performance and efficiency of their business. The extent to which respondents were interested in this information depended on where they saw their business in comparison to others. Most felt it would at the very least be interesting, if not of direct commercial value. Respondents were generally positive about the idea of the publishing of detailed benchmarking data, identifying it as a 'free consultancy service' offered by HMRC.

"It would give me personally some idea that there's some competence in strategic planning at revenue and customs, that they're doing a deal of analysis and that they can be of assistance, since they've got access to it...I think it would put a positive spin on Revenue and Customs." (Professional/business, £500k-1million, 10-49 employees)

Once respondents saw the transparent benchmarking letters they realised that it would not be the detailed information they had initially imagined (see section 7.3).

7.2 Checking accuracy of returns

The idea of benchmarking arose spontaneously, though in a different language, during previous discussion of the potential ways in which HMRC might detect evasion. Thus there was already an expectation that HMRC was using data like this in their compliance work. It was seen as a useful and intuitive tool, which respondents supported HMRC's *internal* use of. However, the communication of benchmarking information was not something they'd considered before, and was not deemed useful to businesses in helping them check their tax returns.

Once transparent benchmarking had been introduced, respondents contended that their incomings and outgoings 'were what they were' and could not be altered if it meant they were outside the average. Their confidence in the accuracy of their own reporting (which either stemmed from confidence in their own ability and experience or confidence or reliance on their accountant) meant that respondents would be unlikely to revisit their tax return after learning they were abnormal. A lack of confidence on the other hand would not prompt a business to check their returns, as those who struggled to understand their tax return would not know where to start to look for mistakes. They would not recognise them easily, and most importantly, sought to avoid dealing with their tax return. Their automatic assumption was not that they would have made a mistake in their figures but rather that there may be something wrong with their business.

"I've got nothing to hide, returns are what they are, I don't care if they don't fit within the benchmarking" (Motor trades/transport, £500k-1million, 10-49 employees)

"Telling me that Joe Bloggs down the road pays something different is irrelevant. If that's my turnover and that's my costs and that's my profit... I can't adjust it based on what somebody else is doing". (Retail/distribution, £100-250k, 2-9 employees, Able to take card payments)

Respondents did not consider using the information to help complete or check their tax returns, or to detect potential errors. When probed on this question, they saw the use being to show if they should reduce the amount of tax paid. Here, respondents envisaged being told they were paying a higher ratio of tax than other businesses would prompt them to work with their accountant to try to reduce the amount of tax they were paying, by investing in the business for example.

"If somebody showed me that they're earning £25,000 and they're paying £1000 less in tax I would need to have a word with my Accountant and see why they are paying that and I'm paying what I'm paying, what I'm doing wrong and what they're doing right." (Motor trades/transport, £30-50k, Sole trader)

7.3 Responses to letters

Introducing the example letters increased respondents' negativity towards the concept benchmarking, in part because their initial hopes for detailed data had been disappointed. This was a research effect, as respondents had had a chance to 'imagine' benchmarking in the abstract, and would not be observed amongst a group that had received the letters 'cold'. The example letters can be found in appendices B and C.

Letter A – pre-filing benchmarking information letter

The first letter shown to respondents was the information that would be received prior to filing the Income Tax Self-Assessment.

The first letter was received by some with indifference; it was seen as a fairly standard information letter from HMRC. A few respondents felt it was slightly too long, particularly those who had less experience and knowledge of tax, though worded clearly. This group also felt that whilst the information did not seem particularly useful or relevant to them, receiving this letter would not affect their feelings towards HMRC.

Some respondents after reading this letter felt that the benchmark once published would still be useful to them in the ways they had envisaged previously, that is that it would be detailed and useful to them commercially.

"I would not object to receiving a letter like that...there is a lot of information in there but actually it is well broken down and again plain English" (Professional/business, £500k-1million, 50-249 employees, Able to take card payments)

Other respondents were more negative about the letter. For some respondents the overall tone of the letter seemed to imply evasion rather than error. The lack of information provided about the benchmark, how it was calculated, and the distribution of other businesses against the average suggested to them that benchmarking would not benefit businesses but was solely a tool for HMRC to use for its own purposes.

"If you haven't done anything wrong immediately you think you have don't you...it would worry me even though I haven't done anything wrong it would worry me" (Retail/distribution, £50-100k, 2-9 employees, Able to take card payments)

"I mean it is telling business, to me it's just telling business how to operate, or insinuating that business is not operating correctly, the business managers.. I would get quite upset about that."(Professional/business, £50-100k, Sole trader)

Respondents took issue with some of the wording in the letter, and felt the language could be softened throughout. The use of the word 'performance' was met with some resentment, as respondents felt it was inappropriate for HMRC to comment on how their business was doing, and unfair to punish them if they were not doing well. This reaction was illustrative of the underlying message respondents took from the letter: that it was more concerned with how a business was performing against its competitors as opposed to whether they were paying the right amount of tax. This perception was borne out by the actions businesses suggested they would take in response to receiving their individual results (see section 7.4).

"It's got a slight accusatory tone to it, but ... you know probably less so than a lot of the letters you get from HMRC anyway" (Retail/distribution, £250-500k, 2-9 employees, Able to take card payments)

"I would make the assumption that they are fishing, and they are using it like they use the adverts...what's it saying to people?" (Construction, £500k-1million, 2-9 employees)

A minority of respondents were confused by what the letter was asking them to do, and were unsure as to whether HMRC was requesting them to provide them with some additional information, or to start calculating their net profit ratio as part of their tax return.

There was mixed understanding of the term Net Profit Ratio, with those who were familiar with filing their tax returns themselves finding it easy to understand, though with others finding it slightly off-putting or confusing. The provision of the formula helped a few of these respondents understand how it worked though they were still unfamiliar with the term and were unclear as to what it meant.

Respondents had a good understanding of benchmarking, having come across it in different contexts (for example, schools), and expressed it most simply as an average for the sector, or comparing one business with others that do a similar type of trade.

Letter B – post filing letter

The second letter shown to respondents was the letter that would be received after filing the Income Tax Self-Assessment, notifying the business that they were outside the benchmark.

Responses to the second letter (informing a business that it was below the benchmark) were varied, but were negative on the whole. The over-arching reaction was one of concern, as the letter implied an impending inspection, and some respondents said they would feel threatened or stressed as a result.

The letter confirmed the suspicions that had been raised by the first letter, that benchmarking was about detecting evasion rather than error. Respondents reiterated their desire for having more detailed information about what being outside the benchmark meant, and what the boundaries of the benchmark level were, so they might be able to determine what caused them to be outside it.

7.4 What would SMEs do as a result

In response to the first letter respondents were not clear about what actions they thought they were supposed to take, with some seeing it only as an information letter that required no response. In the second letter they were clearer that HMRC is asking them to check their returns and contact them – as this is spelt out more clearly.

Respondents were asked what their likely course of action would be if they received information that placed them above, within and below the benchmark. It was thought that being above the benchmark would mean they were paying too much tax. If placed above, respondents believed they would try to find ways to reduce their tax paid, such as by increasing their costs or speaking to their accountant to determine what other businesses were doing that they could imitate. If placed within the benchmark, respondents suggested they would probably feel relieved and would take no further action.

If below the benchmark, as communicated in the second letter, SMEs were unsure as to what their next steps should be (beyond the request to contact HMRC). Most stated that they would speak to their accountant in the first instance. Reactions depended on the respondent's level of confidence and involvement in their tax reporting, and how comparable they thought they were within their sector.

- Those less confident in their tax affairs would **defer to their accountant** and ask them to explain whether it was important and what it meant for them.
- Respondents who felt their business could not be fairly compared with others, and had been particularly negative about benchmarks, said they would **dismiss the information as irrelevant**, concluding that the exercise would be a waste of time for them and HMRC. This group stated they would contact HMRC as directed to explain that their figures were correct;
- Respondents would not check the accuracy of their tax returns as a result of receiving this letter, but rather would **review their business practices** to find ways to improve – with the assumption being that their business was not doing well. Some respondents said that they would feel depressed as a result of receiving this information, with others saying they would consider reducing head count; and

"I don't know it might depress me seeing something like that because we'll probably be right at the bottom compared with all these bigger garden centres". (Retail/distribution, £50-100k, 2-9 employees, Able to take card payments)

Smaller SMEs and sole traders lamented the time and cost that benchmarking would entail for them – both in the time they may need from their accountant and the loss of earnings they would expect as a result of the time spent in the tax inspection. Others who would not defer to an accountant pointed to the time burden entailed in going through and checking all returns and records to try to find an error. They also objected to HMRC asking businesses to call them at their own expense, despite the acknowledgement in the first letter that there could be legitimate reasons a business may be outside the benchmark. This resentment contributed to the resigned response that benchmarking was 'just another thing HMRC was making businesses do', and the assumption that this would cost them money.

"Why should I have to call the revenue on a number, and by such and such a time and explain why I choose to run my business, and it's outside their benchmark?"
(Professional/business, £1million+, 10-49 employees, Able to take card payments)

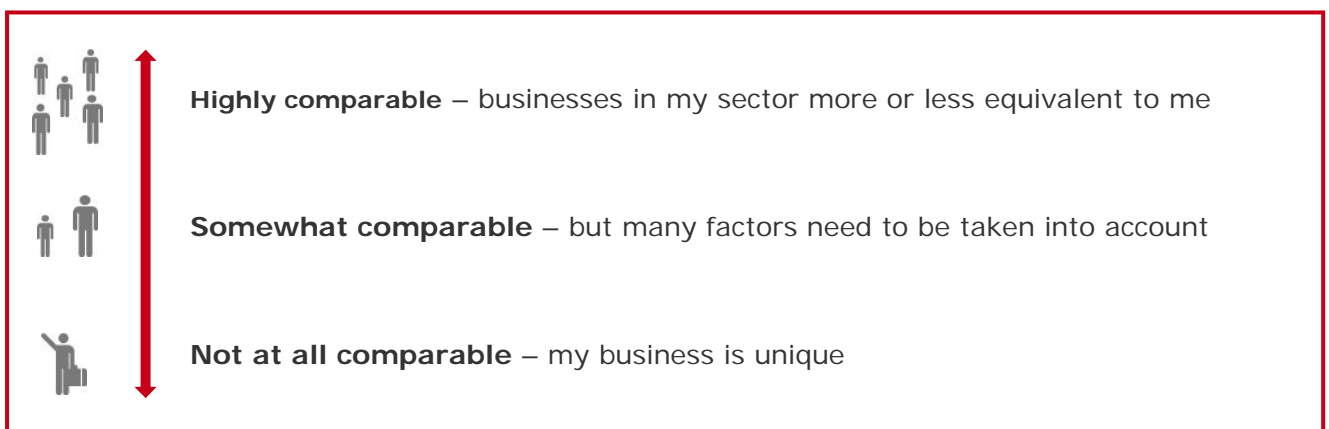
Some businesses admitted that they would be unlikely to read this letter in any depth, as they were fairly disengaged from HMRC communications generally. These respondents expected to pass the letter onto their accountant or skim read it and put it aside. This was particularly the case for the first letter, which was seen as a generic piece of information. Respondents felt it could be made more user-friendly and digestible.

"Probably read half of it. And probably put it to one side because it would come out at the same time as, like, remember to do your returns, and it would probably sit in a pile until the return was done and then it might be another flick-through and, oh, maybe that's interesting, I'll do that later, is probably the response." (Professional/business, £50-100k, 2-9 employees)

7.5 Comparability and fairness

The variation in reactions to transparent benchmarking hinged on the type of business the respondent had and whether they felt they were comparable to other businesses.

Figure 4: Scale of comparability



Where a business saw themselves on the scale of comparability determined their perception of both the utility of the data for them and for improving compliance. This in turn influenced their perception of how fair it was for HMRC to compare them in this way.

Businesses that saw themselves as simple or comparable within their sector were most likely to recognise the usefulness of benchmarking information. They tended to be fairly small-scale and based on simple business models, with activity usually straight-forward and time-bound, such as small-scale manufacturing, construction or engineering, or retail and catering. These respondents tended to have an existing sense of where they sat within their sector average, and would seek out this information locally. For example, if similar businesses were looking to merge or sell, these business owners would seek out the turnover and profit levels in order to measure themselves against the business for sale. Respondents in this group saw the benefit to them of having access to benchmarking data, and were more likely to be positive about the potential for HMRC to use it to detect evasion.

Those in the middle of the scale suggested that benchmark data would probably be interesting but was unlikely to be useful to them. There were several factors affecting where a business saw themselves in relation to comparability to others (listed in order of relative strength of frequency of mention):

- **Geographic location** – SMEs recognised that businesses in different areas of the UK would have quite different operating costs and relative levels of income. This was almost universally mentioned by respondents.
- **Size** – respondents felt that the size of the business both in terms of turnover and number of staff would need to be taken into account in any comparison
- **Structure and scale** – related to size, respondents felt that independent businesses could not be compared to large-scale or high-street chains
- **Costs** – several factors were brought up in relation to the cost of running a business, including:
 - whether or not the business owned or rented their premises, and whether they generated any additional income from owned premises;
 - the age of the business, with new businesses still operating at a loss;
 - how well a business remunerated its staff, as salaries were related to profitability;
- **Tax relief** – capital investment and debt relief were mentioned as factors affecting the total tax paid by a business; and
- **Partnerships** – the way in which partners were paid by a business was felt to complicate tax affairs.

"I don't think it would be particularly handy because it depends on how much money you have put into the business in the first place, as to how much tax you pay; how much profit you make. So, unless you had all that information, it wouldn't really make any difference to be perfectly honest with you". (Catering/leisure, £50-100k, 2-9 employees, Able to take card payments)

Respondents were also keen to point out that multiple undocumented factors existed that were largely unmeasurable. These included the efficiency of the business, the energy and drive of an individual and the amount of work taken on (particularly for sole traders), and the effectiveness of a team. These were deemed to be part of the nature of business, and

discussion of these aspects tended to lead to the conclusion that no businesses could be exactly alike.

"I would just say there are some businesses in my sector and that size who are doing well, there are some are doing pretty poorly, ... and at the end of the day just to try and level everybody should be paying the same amount of tax is ridiculous."
 (Professional/business, £50-100k, Sole trader)

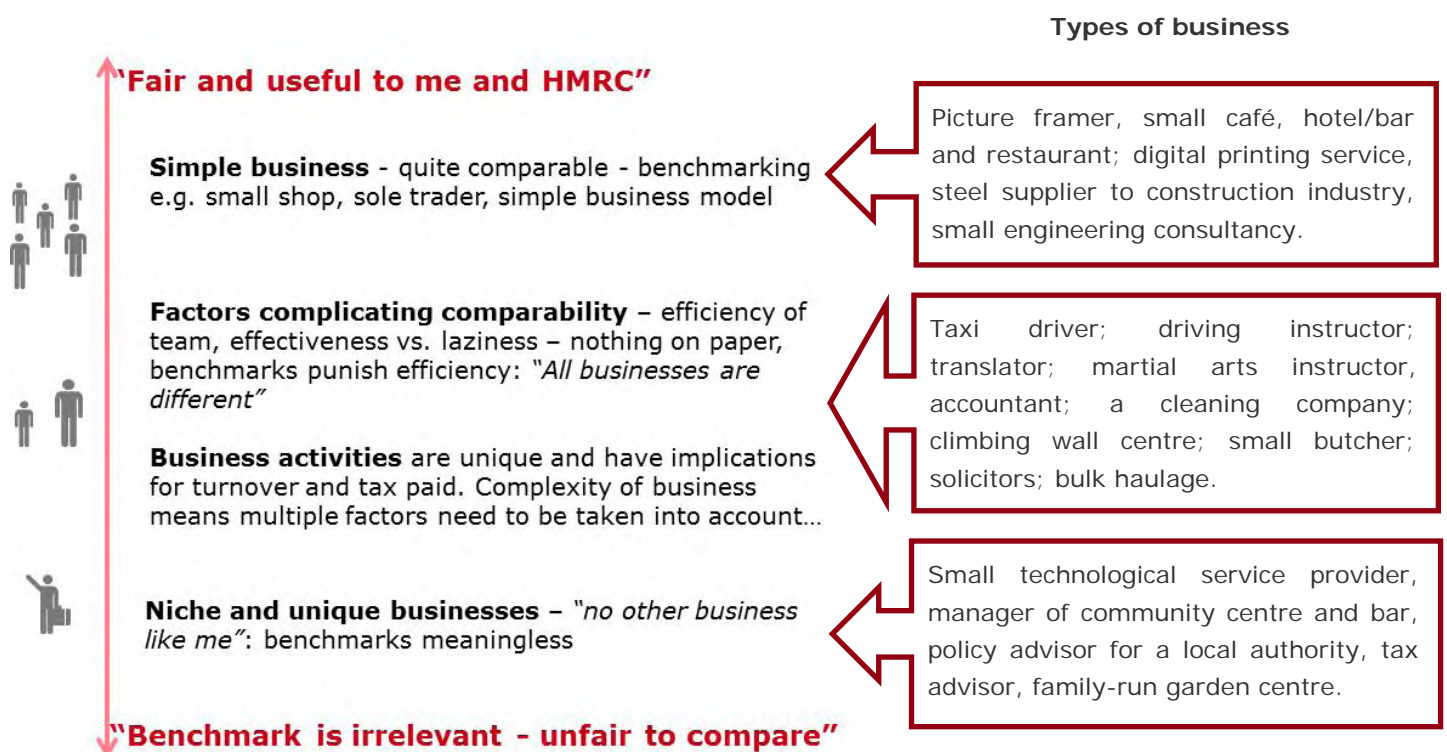
Those in more niche sectors, who did not know of any other businesses like them, were less commercially interested in this data, feeling it would be largely irrelevant to them or that it wouldn't make sense to even make a comparison. They often felt that they did not really have any competitors. As this group could not see how this data would be relevant or useful to either them or HMRC, they tended to interpret benchmarking as an unfair scheme that would result in greater scrutiny of their business by HMRC. The idea of fairness featured much more strongly in discussions of benchmarking amongst this group.

"I don't know, I really don't know. I mean... the will writing business... isn't a coherent business area at all". (Professional/business, £30-50k, 2-9 employees)

"It would have to be exactly similar otherwise it's just totally irrelevant information"
 (Professional/business, £1million+, 10-49 employees, Able to take card payments)

The extent of comparability was also affected by whether respondents knew of other businesses like them within their area. Competition was assumed to be confined to local horizons and known businesses, which was important to respondents' reactions. These respondents thus identified themselves as unique businesses, despite the fact that other businesses similar to them were likely to exist, such as an independent butchers.

Figure 5: Views about comparability by types of business



7.6 How it should be communicated

Respondents stated their own preference for benchmarking communications to be used as a means of opening up lines of communication with HMRC to provide businesses with support, rather than to imply businesses were evading. Whilst they (as a broadly compliant group) preferred lighter touch interventions, such as offers of help, they acknowledged that these would probably not prompt evaders to rethink their decision to evade, and that threats of audit were much more likely to be effective amongst that group.

"I guess it's an example of the big brother type approach... rather than the supportive type approach" (Catering/leisure, £100-250k, 10-49 employees, Able to take card payments)

"I think it needs to be made very, very clear that some errors are inevitable and that the aim of HMRC is not to punish. I think that message has to be really strongly conveyed so that people buy in and don't just back off and hide."
(Professional/business, £500k-1million, 50-249 employees, Able to take card payments)

Respondents indicated that receiving information by letter was fine and appropriate; though if HMRC was providing a support channel for business to check mistakes they would ideally like to be able to contact someone via telephone. Their ideal communication channel was for a letter to be sent to explain benchmarking and a direct line to be offered for those seeking help.

7.7 Effect on compliance

However, respondents did not feel that communicating this message to businesses would necessarily have a positive effect. Respondents had previously mentioned that they thought it was unlikely that evaders would allow their figures to fluctuate drastically as this would flag them for investigation. Similarly, they believed evaders were unlikely to allow their figures to lie outside the benchmark, and that publishing the benchmark would result in evaders' manipulation of their figures to fall within the accepted limits.

Another unintended consequence of publishing benchmarking data related to those who would be told they were above the benchmark. Respondents expected this would result in businesses attempting to reduce the amount of tax paid, such as by slowing down business activity to try to depress income, thus resulting in less revenue for HMRC overall.

However, those who suspected high levels of evasion within their sector, or who were positive about the potential commercial use of benchmarking data, were optimistic about potential compliance benefits. They therefore felt it was logical to use a benchmark to detect and investigate outliers. Their expectation was that communicating this information could have a deterrent effect on those considering evasion, mainly those falling into the fudging/chipping and cash-in-hand types of evasion.

7.8 Implications

The desired effect of transparent benchmarking, i.e. prompting businesses to check their returns for errors, was not immediately apparent to businesses. Rather, the benchmark was interpreted as a statement of their business performance as well as a threatening message that HMRC was going to investigate them. Respondents did not see benchmarking as a prompt to check if they were compliant; their default position was to defer to their accountant and review their business efficiency and costs. On receipt of the first letter, businesses are unsure as to what their next steps should be. More practical, specific guidance could therefore be offered about what should be checked and how a business could go about this.

Businesses were also wary of any increased burden that may be placed on them by HMRC. This could negatively impact on businesses' feeling towards HMRC, if it could sap further time.

The more contextual information published alongside the benchmark data, the more businesses expected to view benchmarking as a mutually beneficial scheme for themselves and HMRC. Publishing more data would not only give the impression that HMRC was attempting to support businesses but would also help SMEs determine their next steps once they received the benchmarking information.

8. Conclusions

Interpretations of what compliance means have not changed since the 2012 research, defined by SMEs as paying the right amount of tax, on time, and keeping accurate records. The types of evasion expected to be most common reflected and supported previous findings, with views based on what was seen (or not seen) within an individual's sector, and what was heard in the news. Overall, SMEs did not find it easy to estimate the prevalence of evasion, given their limited experience of such activity within their sector and the lack of media coverage. Views on evasion and prosecution were based on very limited information sources: either news reports; HMRC campaigns; or direct contact with HMRC. These sources could have a disproportionate impact on views, meaning perceptions were potentially volatile.

Whilst it was difficult for SMEs to determine how much effort HMRC put into compliance in relation to its other activities, there was a widespread perception that there had probably been a recent reduction in resource due to wider Government cuts. The impact of this view was that SMEs expected HMRC to target their strategy in order to maximise returns, a move which they felt resulted in SMEs themselves being the focus of HMRC's attention.

SMEs had limited awareness of HMRC's strategy for detecting evasion, though it was assumed that a relatively large component of it was random. The view that audits were conducted at random existed alongside the assumption that intelligence sources were used to detect potential evasion. These sources included HMRC 'agents' picking up on suspicious behaviour, or automated IT systems at HMRC flagging sudden fluctuations in figures submitted in returns. SMEs also lacked awareness of the kinds of information HMRC held about businesses, and on the whole presumed that only returns data was routinely accessed and checked. There was also a pervasive view that HMRC did not routinely match data on businesses. Whilst SMEs with lower IT and tax literacy suspected that HMRC could potentially conduct universal data-matching, the prevalent view was that this did not take place as standard but would need to be in specialist, targeted teams within HMRC, and only after a business had been flagged as suspicious via another intelligence source.

As there was a presumption that HMRC only accessed tax returns, except during an investigation, SMEs did not expect that HMRC already collected Merchant Acquirer data. However, they were unsurprised to learn that they could, and deemed it to be a fair and reasonable method for detecting evasion, particularly as it appeared to be aimed specifically at 'criminal' evaders. The group of SMEs researched initially struggled to imagine how this data might be used to tackle evasion, as they were unaware of 'plastic' data evasion strategies, considering it to be almost impossible to elude detection. Broadly compliant SMEs could therefore react with indifference to communications about HMRC's access to Merchant Acquirer's data, as without illustration of the kinds of evasion it could discover, it was not expected to produce a significant compliance benefit.

SMEs required reassurance that Merchant Acquirer data would be secure, due to concerns about government data leaks, and that personal information or purchasing data would not be

provided to HMRC. Respondents also expressed scepticism about HMRC's IT and data matching capability given the assumption of reduced resource and the perception of current systems used. Any communication about Merchant Acquirer data use may therefore need to underline and demonstrate data mining and matching competence.

The purpose of transparent benchmarking was assumed to be about deterring evasion by demonstrating that HMRC was scrutinising individual businesses. The tone of communications used during the research suggested to respondents that rather than being a prompt for businesses to check for errors, benchmarking was a statement of business performance as well as a threat of impending investigation. This association with evasion could be lessened by highlighting the fact that one could be outside of a benchmark as a result of an error in reporting. The provision of more information published alongside a business' result was expected to make the tone less threatening. It would also introduce benchmarking as something that could be mutually beneficial for both businesses and HMRC.

The default position amongst respondents in response to letters on benchmarking would be to defer to accountants and review their business efficiency and costs. Businesses were unsure as to what their next steps should be, and more practical, specific guidance could therefore be offered about what should be checked and how a business could go about this.

Businesses were wary of any increased burden that may be placed on them by HMRC. This could negatively impact on businesses' feeling towards HMRC, if they felt they were being asked to conduct time-consuming and potentially costly checks and procedures, despite being told that they could be legitimately outside the benchmark.

9. APPENDIX A: Discussion guide

HMRC CPS QUALITATIVE DEPTH INTERVIEW DISCUSSION GUIDE

Aims: to

- Explore SME understanding of how HMRC currently uses information in its compliance strategy and, specifically, how the use of Merchant Acquirer data and published benchmarks will affect perceptions of compliance.

Key objectives of the research are to explore:

1. Interpretations of compliance and evasion
2. Perceptions of likelihood of detection for evasion and error
3. Perceptions of HMRC compliance strategy, including resourcing and effort
4. Merchant acquirers information and perceptions of what information HMRC holds
5. Benchmarking and potential impact on customer behaviour

Protocol:

- About the research: this piece of work is for HM Revenue and Customs to help them explore understanding of how HMRC currently uses information to improve the honesty and accuracy of tax returns
- TNS BMRB is an independent research agency working on behalf of HMRC
- Length of discussion: 60 minutes
- Confidentiality and anonymity: their participation in and contributions to the research are kept strictly confidential, and they will not be identified to HMRC

Introductions and background (3 mins)

Background

- Respondent business details
 - Nature of business – sector, size, activity
 - Age of business
 - Income Tax Self Assessment?

- Nature of contact with HMRC
 - What instances, and how frequently, do they contact HMRC

Interpretations of compliance and evasion (6 mins)

Aim: To gauge respondents' understanding of compliance and 'evasion'

- Explore what respondent understands 'doing the right thing' to be in relation to their tax affairs
 - What does this entail
 - Would other businesses have different interpretations
 - What types/sizes/sectors; what would be different
 - ?Whether they think their interpretation is different from HMRC's
- Any areas of difficulty, or particular burden
- Any 'grey' areas of uncertainty or ambiguity as to how get it right

- Explore interpretation of '**tax evasion**' or not doing the right thing
 - What does this mean – is this different to not doing things right by accident.

IF SO (only cover the rest of the section if respondent sees a distinction between non-compliance and evasion):

- How do they define tax evading behaviour; what does it entail
- Examples of evasion
- Explore any ambiguity around their definition of tax evasion
- ?What are the 'grey' areas in evasion (linked to the above, on compliance), room for error or for doubt
- Describe what tax avoidance is, by comparison

Perceptions of resourcing and effort (6 mins)

Aim: Explore perceptions of tax evasion prevalence, HMRC resourcing and effort

- Explore perceptions of **prevalence** of evasion
 - What types of businesses tend to evade tax
 - When, and why, do businesses evade tax
 - How businesses most commonly evade tax
 - Explore whether some taxes are harder to evade than others e.g. VAT registration/3-line account threshold
 - Whether the number of businesses evading has changed over recent years
 - How; why they think this is happening
 - What are these perceptions based on
- Explore general perceptions of HMRC's **compliance effort**
 - Whether compliance effort is at the right level, and reasons for this
 - Explore perception of the proportion of businesses that evade that get caught
 - What this is based on
 - Whether this has changed in recent years
 - If so, how
- Explore perceptions about HMRC's **level of resourcing**
 - Whether HMRC is putting more resource into compliance, or not

- Whether this has varied over time; if so, in what way (impact of the economy etc)
 - What their views are based on – sources of information

Perceptions of compliance strategy (7 mins)

Aim: To explore awareness and expectations of HMRC's compliance strategy

- Do you think that HMRC look at all businesses in the same detail
 - Are there certain checks that you think that they always do
 - What kinds of checks; why
 - Are there some checks that they might do for certain types of businesses
 - What sorts of things
 - How would they select the businesses
- How do you think HMRC decides on which businesses to audit
 - What is this based on
- What information is used when completing returns
 - Is there anything in particular you do to help get them right / avoid errors
 - Specific information
 - Triggers that prompt them to review reporting
 - Any information from HMRC that helps
- Probe awareness of any work that HMRC do to support compliance
 - Explore how heard about; what they think of it
- What information and support do you think is available from HMRC to businesses Spontaneous and probe:
 - Education, software packages, pre-population
 - What they think of it
 - Effectiveness in encouraging compliance
- Is there anything that HMRC could provide that would help you with your tax returns
 - What / how would it help

Perceptions of what information HMRC holds (8 mins)

Aim: To explore views and perceptions of HMRC's capabilities for acquiring pertinent data for compliance purposes

- How do you think HMRC detect errors;
- How do you think HMRC detect evasion
 - Spontaneous, and probe
 - Would they be detected in the same way, or would they differ, and how
- What kind of information do you think that HMRC holds about businesses and their finances
 - Spontaneous, then probe:
 - Bank accounts
 - Individual salary payment
 - Property transactions
 - Letting income
 - Credit / Debit card transactions
 - Government contracts

- How do you think they use this information

Probe:

- For detecting errors / tax evasion
 - How would it help detection
 - For your business/other businesses that you know
- What capabilities do you think they have for matching this data up – i.e. bringing these different bits of information (discussed above) together
 - Prompt: E.g. match it up to your tax records / other information that they might have on you.
 - Explore credibility
 - Do you think they use these capabilities
 - For which types of business/ in what situations would they match data up
 - Is this something you have considered before
 - How do you feel about this
 - Does it affect
 - what you do
 - how you feel about HMRC

Researcher probe for any examples of incidents they are aware of, that relate to this subject

Merchant acquirers and perceptions of what HMRC holds (15 mins)

Aim: Explore merchant acquirer data and perceptions of what HMRC holds

Researcher note: Spend more time on this section for traders who can take credit cards

Researcher explain: Merchant acquirers are the companies that process card payment transactions. Businesses need to be registered to one of these merchant acquirers in order to receive credit or debit card payments. Under new powers, HMRC will now receive information from the merchant acquirers. This will provide HMRC with details of all the transactions by debit and credit card paid to a business, i.e. through their card payment terminal or online. HMRC will not be receiving information specific to each transaction or specific to an individual – but rather aggregated data for the month, e.g. 300 transactions at a total of £5000 in January.

If necessary - It is only the details relating to the business (i.e. the ones receiving payment for goods or services) that will be passed to HMRC. No personal data identifying the person making any of the purchases will be passed to HMRC.

Examples of some of the transactions covered / not covered:

Someone buying something in a shop or online – if a business accepts payments through a card payment terminal or online, then the total number and value of all card transactions completed by the business will be provided to HMRC. The details relating to the person making the purchase will not be provided to HMRC.

E-wallets – not covered. E.g. transactions paid through e-wallets (a company like Paypal) on an e-marketplace (a company like e-bay) would not be provided to HMRC. An individuals' credit and debit payment history – not covered. E.g. HMRC would not be able to find out what someone bought at the supermarket (or any details about the person making any payments).

An individuals' credit and debit payment history – not covered. E.g. HMRC would not be able to find out what someone bought at the supermarket (or any details about the person making any payments).

- Explore reactions, spontaneous and probe:
 - is this surprising/ not surprising – why;
 - whether previously aware of this
 - whether expected this information was already being collected
- Views on collection of the data. Spontaneous, and probe:
 - Is this reasonable, fair, appropriate for HMRC
- How do you think they could use it – what are the possibilities
 - What do you think it could help them to do
 - What do you think their capabilities would be
 - How significant a difference do you think this will make
 - How far 'plastic' data is different to cash data (in terms of improving compliance)
 - How do you feel about this
 - How effective do you think they would be at using it for this purpose – is this likely to happen
- How do you think they will use it, i.e. how are they likely to make use of this information in practice
 - How do you feel about this
- What do you think the impacts of this will be on businesses
 - Which types of business will be most affected
 - Is it just those who take card payments or are there wider compliance benefits
 - What could happen to them as a result
 - Probe: is this a better method for targeting dishonest businesses
 - If so, what makes this approach better
- Do you think that HMRC should make businesses aware of this information
 - Why/ why not. Spontaneous, and probe:
 - To affect people's behaviour
 - Obligated to let businesses know
 - Any reputation/ credibility issue
- How do you think businesses will respond (businesses like yours; other types of business too – *let respondent select the businesses they consider to be relevant/ affected*;
Probe for both positive and negative changes in behaviour:
 - e.g. *increasing honesty of declarations, encouraging the cash economy, change to taking cash transactions only*
 - Will it be seen as relevant or important
 - If so, to which types of business
 - Will it change their behaviour at all
 - If so, in what ways
 - Prompt: could it make them more or less likely to take care with reporting all transactions in full
 - What would determine whether or not they change their behaviour
- Could the information be useful to businesses in any way
 - If so, how
 - Reasons for this

Researcher explain that we will consider a couple of case studies of business behaviour.

Researcher note: read out each case study separately, and then ask questions below.

Case Study 1

The data that HMRC received has identified a dry cleaner that over the last year has received £100K of sales where the payment method was debit / credit card. HMRC has not been able identify any tax record for this business.

- What does this suggest about the business
- What do you think HMRC will do
- What will the consequences for the business be
- Does this change your view of how useful this information will be to HMRC / businesses

Case Study 2

The data that HMRC received identifies a florist that has more than one account for processing their debit – credit cards sales. When HMRC add these together the total for a year comes to £250K. The business is registered for tax. For the same period they declared a total turnover of £210K.

(Ask same questions as above)

HMRC sometimes runs campaigns that offer people a chance to get their tax affairs in order on the best possible terms. If someone has underpaid tax and they want to declare all their income voluntarily and set the record straight, they can make a report to HMRC and pay the tax. This means that they avoid the risk that they will be investigated and prosecuted.

- How does that make you feel?
- Do you think it is fair?
- Are there any advantages / drawbacks for HMRC to this approach?

Transparent benchmarking (15 mins)

Aim: Benchmarking and potential impact on customer behaviour

Researcher note: Spend more time on this section for small traders (e.g. sole traders, small businesses under £50k)

- Do you ever think about **how your finances and tax reporting compare** to other businesses similar to yours (your trade, your size) in terms of turnover and tax paid
 - Why is this information interesting/ useful/ uninteresting/ unimportant
 - Where do you think you sit compared to them
 - Have you ever tried to find out – and how (e.g. by talking to other traders)
 - Do you have a sense of what the 'average' is for your sector
- When you are completing a tax return, **what information is useful** to you to help you ensure accuracy
 - Would it be useful to know the average tax paid by businesses like yours
 - If so, in what ways – how might you use it
 - what might it help you to do
 - If not, why not

Researcher explain: HMRC will start sharing information with businesses about the average tax contributions in their sector, to help them check their own returns...(include mention that HMRC have always had this info – and believe it could be useful to businesses to help them get their tax returns right)

- What are your **initial thoughts** on this
- How would you expect HMRC would use this data
 - Reasons for this

- Any effect on **feelings about HMRC** – what and why (researcher probe in depth)
 - What would this say to you about how HMRC is working with businesses
- Do you think this sort of information would be **useful to you**?
 - How? In what way?
 - Anything in particular that it would help with?
 - Probe: reassuring those within benchmarks; encouraging those outside to check their filing
- **How would you feel** about HMRC comparing you to other businesses
 - Reasons for this
- **Would it be fair/ relevant** to compare your business with others
 - Reasons for this – including comfort/ discomfort
- **How similar** to you would the business need to be for it to be useful
 - Would an ‘average’ benchmark work in your sector-
 - Reasons for this
 - What would in need to be based on, for it to be credible
 - What sort of range would it need to be (in terms of % NPR)?
 - How specific to you would it need to be?
 - PROMPT: Location, Sector, Size of business, geographical area
 - What kind of information and messaging would be most helpful from HMRC to encourage people to use this, and to value it
- **What would you do if you received information?**
 - **That showed you were below / above / in line with the benchmark**
 - Would you have to **speak to anyone** about it? – Where would you go for this support?
 - Whether they would consider this a **burden** on their time/resources; e.g. costs of accountant, time checking reporting/seeking advice
- If HMRC is **using benchmarking data specifically to detect errors (being careless) and deliberate misreporting (‘creaming’)**, how would you feel about it?
 - Would it change your behaviour
 - Would it be likely to change other people’s behaviour, if they find out about it
 - How would they respond – how would/ wouldn’t
 - Their attitudes change, and why
 - Their behaviour change, and why

Researcher to introduce letter and explain it is a mocked up example letter from HMRC – ask respondent to imagine what their response would be if they received this letter in the post **before** they had completed their Income Tax Self Assessment – allow them to read through.

EXAMPLE: INTRODUCE BENCHMARKING LETTER 1. Give respondent the first letter stimulus, which customers would receive before they completed their ITSA return.

- Spontaneous reactions
- How would you feel about getting this letter
 - Reasons for this. Spontaneous, and probe:
 - Any effect on feelings about HMRC – **what and why** (researcher probe in depth)
 - What are the key points that they are trying to get across
 - What do you think you’re supposed to do
 - What would you do – spontaneous, then probe -
 - any advice needed / further support / contact HMRC
 - Is the information useful?

- How? In what way?
- Is there anything that you don't understand?
 - What is understood by benchmarking
 - What is understood by net profit ratio
 - Explore clarity of these terms
 - Any sections / words in the letter that they don't understand

Researcher to introduce second letter and ask respondent to imagine what their response would be if they received this letter *after* they had completed their Income Tax Self Assessment – allow them to read through.

EXAMPLE: BENCHMARK LETTER 2. Give respondent the second letter stimulus .This would be sent to customers who have completed their tax return and are outside the benchmark.

- How would you feel about getting this letter
 - Reasons for this
 - Would it make you do anything; what/why
 - What they think they are supposed to do
- How do you think HMRC should use this information in communicating with businesses;
- Which businesses should they share this information with; any groups who shouldn't receive this information
- What **kinds of message** from HMRC do you think **would prompt businesses to review their returns**, in case of error (e.g. being careless) or deliberate misreporting (e.g. creaming). Spontaneous, and probe:
 - Offers of help
 - Threat of penalty
 - Threat of audit

NOTE TO INTERVIEWER: ENSURE THAT YOU GET LETTERS BACK FROM RESPONDENT. UNDER NO CIRCUMSTANCES SHOULD THEY BE LEFT WITH THEM

Thanks and close

10. APPENDIX B – Stimulus letter (pre ITSA)

Transparent Benchmarking Team



«Mail_Address_Name_»
«Address_Line_1»
«Address_Line_2»
«Address_Line_3»
«Address_Line_4»
«Address_Line_5»
«Postcode»

Pho 0845
Monday to Friday 8.00am to 6.30pm

www.hmrc.gov.uk

Date «Date_of_Issue»
Our ref individual reference from

1. Benchmarking for Tax Year 2013/14 – How does your performance measure up?

2. Dear «Letter_Name»

3. Do you want to know how your business is performing compared to other businesses in your trade sector?

4. Benchmarks will allow you to do this.

5. What is benchmarking?

6. HMRC is publishing benchmarks using data our customers give us to show you how your business performs against others in your industry.

7. For businesses in your trade sector with a turnover between [X and Y] we have analysed every Income Tax Self Assessment (ITSA) return for the last 3 years and the **normal net profit ratio for businesses like yours is between [Z and A].**

8. 70% of businesses have their net profit ratio within that benchmark.

9. The attached help-sheet will help you to work out your net profit ratio (NPR).

10. Why are you writing to me?

11. Your trade sector has been chosen for the testing of net profit ratio benchmarks for the tax year 2013/14. Our records indicate that your business comes under this trade sector.
12. Knowing how your profits measure up to those of your competitors can help you to assess the health of your business and it can help you to see if you are filling in your return correctly.
13. We know that you care about getting your return correct and that you want to pay the right amount of tax for your business. You can use the benchmark we have given you above, and the attached help sheet, to check that you correctly complete your 2013/14 ITSA return.
14. If you need more information on getting your tax right you can go to the HMRC website www.hmrc.gov.uk

15. Why are HMRC interested in this?

16. It is important that you take care when completing their ITSA return and that that you pay the right amount of tax.
17. Your tax helps pays for vital services in your area such as hospitals and schools.
18. Benchmarks help us to assess whether we consider a business is correctly filling in their ITSA return. There can be good reasons why a business might fall outside the benchmark, the industry norm, and have a lower net profit ratio than comparable businesses, but we might be more interested in your business if your return falls outside the benchmarks and we might want to check that you are completing your return correctly.
19. We use a number of different parameters to decide which businesses we should visit or ask for further information. In the future, we may assess how each individual business performs against the benchmark for their sector and use that information as one of the parameters to decide whether they should be visited or asked for further information.
20. This year we are just testing benchmarks to see whether they help businesses to get their returns right and whether they help HMRC to identify either those businesses who need further help, or those whose returns may not have been correctly completed.

21. What should I do now?

22. You should complete your 2013/14 tax return as usual
23. You should take time to check all your figures before you submit it to us because it will help you to make sure you pay the right tax
24. If you are outside the benchmark, don't worry. If you are certain that your figures are correct then you should submit the correct return. We know that some businesses will be legitimately outside the norm.
25. While we are running this trial we may come back and ask you to explain why you are outside the benchmarks, to help us to understand better how to identify businesses who are still making errors from those who are legitimately outside the benchmark. We may be more interested in your business if your return is outside the benchmarks.
26. Yours sincerely

27. Transparent Benchmarking Team

Self Assessment – What you need to know about using the Net Profit Ratio benchmark

You can easily work out your Net Profit Ratio (NPR) from the figures you input on your ITSA return – even if you are only submitting a short return.

Once you know your NPR you can use the benchmark to help you compare your performance against similar businesses in your industry.

If you find you are outside the benchmarks for your industry, check that you have correctly recorded and reported income and deductions for your business.

How To Work Out Your Net Profit Ratio

$\frac{\text{Net Profit}}{\text{Turnover}} \times 100 = X\%$

Turnover

What we mean by Net Profit

Net Profit is calculated by starting with a business' total turnover. From this, the cost of sales, along with any other expenses that the business incurred during the period, is removed to reach earnings before tax. Tax is deducted from this amount to reach the Net Profit Number.

Another way of understanding Net Profit is:

Net Profit = Gross Profit less Expenses.

What We Mean By Annual Turnover

If you are self-employed or receive income from property, "turnover" means the total income earned from your business or UK property. It includes:

- Cash and cheques
- Tips, fees and commissions
- Value of any payments 'in kind' for work that you've done
- The value of any stock or goods taken without payment from the business for use by you, your family or your friends
- Money due to you up to your accounting date whether or not you have actually been paid
- Income from any land that you own or lease out
- Income from any property that you let
- Any rent over £4,250 from a furnished room in your own home.

It does not include:

- Money received from the sale of a piece of equipment or machinery that you have previously owned and used in your business
- Money received from the sale of business premises
- Business Start-up Allowance or Enterprise Allowance

If you have been self-employed or have been receiving income from property for less than a full tax year, or if your accounting period is shorter or longer than 12 months, then the annual turnover limit goes down or up proportionately.

Examples

Example 1

A self-employed builder works out his Net Profit Ratio is 34%, which is below the benchmark "norm" for his industry which starts at 36%. He re-checks his figures and sees he has not included two invoices in his return. He corrects his return which now shows he is within the benchmark "norm" for his industry and submits it to HMRC.

Example 2

A vet works out her Net Profit Ratio is 46% and just over the average in her industry's benchmark "norm". She is very pleased with this as she had put several plans in place that year to improve her business' performance.

11. APPENDIX C: Stimulus Letter (post ITSA)

Transparent Benchmarking Team



«Mail_Address_Name_»
«Address_Line_1_»
«Address_Line_2_»
«Address_Line_3_»
«Address_Line_4_»
«Address_Line_5_»
«Postcode»

Pho 0845
Monday to Friday 8.00am to 6.30pm

www.hmrc.gov.uk

Date «Date_of_Issue»
Our ref individual reference from
00

Dear «Letter_Name»

Benchmarking – Are you happy with your performance?

Why are you writing to me?

In XX 20XX we sent you a letter about the introduction of the publication of a benchmark in your industry.

We explained that this is one of the pieces of data HMRC uses to assess if further contact is needed and we are likely to have more interest in your business if your return is outside the benchmark.

Your 20XX/XX return shows you are outside the “norm” for performance in your industry.

What should I do now?

You should check you are happy that your return is correct and accurate.

You will then need to call us on XXXXXX by XX/XX/XX , quote the reference at the top of this letter and either:

- 1) Explain what amendments are needed to be made in your tax return.
- 2) Confirm your tax return is correct and answer a few questions so we can better understand why some businesses will be legitimately below the benchmark norm.

If you have registered a tax advisor to deal with us, they can call us on your behalf.

Yours sincerely

Transparent Benchmarking Team

12. APPENDIX D: Sample breakdown

Sector	No of employees	Turnover	Segment
Retail/wholesale/distribution: 5	Sole traders: 11	Under £50k: 8	Need help: 1
Professional/business service: 12	2-9 employees: 11	£50-100k: 8	Payment deferrers: 2
Catering/leisure: 5	10-49 employees: 6	£100-250k: 4	Potential rule breakers: 17
Motor trades/transport: 5	50-249 employees: 2	£250-500k: 1	Rule breakers: 4
Construction: 3		£500k+: 9	Unaware: 1
			Willing and able: 5

Other: Able to take credit or debit card payments: 14

With the Professional/business service sector there was a wide range of businesses, including:

1. Textile printers
2. Accountant (construction)
3. Professional will writer
4. Policy advisor for charities
5. Solicitors
6. Private photographer
7. Commercial cleaners
8. Chartered Surveyors
9. MD of a commercial/domestic cleaning company
10. Head of finance for a specialist firm of highways, traffic, transportation, and water consulting engineers
11. Geo-information technologist/consultant
12. Translator/interpreter

13. APPENDIX E: Analysis methodology

All interviews were recorded and transcribed. Following a researcher brainstorm, an analytical matrix was produced based on the emerging themes and research objectives. Perceptions of compliance and the factors underpinning views were then mapped onto the matrix for each interview to provide granular analysis of individual interviews, and to facilitate thematic comparisons between interviews.