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Trade Information among Unregistered VAT Businesses

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HM Revenue and Customs Research Report 460

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Glossary

Business-to-business (B2B)	Businesses that make most (i.e. more than 60%) of their sales to other businesses.
Business-to-consumer (B2C)	Businesses that make most (i.e. more than 60%) of their sales to the general public.
Company	This is a separate legal entity to its shareholders and directors.
Digital services	Services that are delivered via an electronic network including music, games and film download and computer software. These do not include sales of physical goods via the internet.
European Union (EU)	The EU countries are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom (UK).
Goods	Tangible products such as books, clothes and tools.
Input costs	Overhead items used in the production of goods and services. Businesses were asked to exclude wages and salaries, PAYE and National Insurance contributions, money taken out of the business, loans, dividends and gifts of money, insurance claims, Stock Exchange dealings, MOT certificates, motor vehicle licence duty and local authority rates.
Nano business	A business with no employees.
Partnership	In a partnership, partners personally share responsibility for the business. This includes the business's profits and any losses the business makes.
Services	Activities done for other people or businesses such as providing financial or legal advice or an online server.
Sole trader	Running a business as an individual and self-employed. Sole traders can keep all their business's profits after they've paid tax on them and are personally responsible for any losses their business makes.

1 Introduction

1.1 Background

Value Added Tax (VAT) is a charge put on goods and services within the European Union (EU). Every member state has a form of this tax, and all are required to send a proportion of VAT receipts collected straight to the EU to finance its budget. As VAT rates and laws vary across the EU, the UK and other EU Member States are required to make adjustments to their VAT calculations to ensure that the amount paid by each Member State is fair. The UK's VAT threshold is £83,000 which is considerably higher than all other Member States' thresholds¹.

The UK simulates what its VAT receipts would be were its threshold set at a lower agreed EU wide threshold; the UK then pays a proportion of these simulated receipts to the EU. This simulation is conducted by HMRC which estimates the value of sales by VAT unregistered businesses to the general public. Only sales to the general public are considered because businesses can generally recover VAT, so the UK would only receive VAT receipts from sales to the general public.

The main aim of this research was to **provide robust estimations of the percentage of Business-to-consumer (also known as B2C) sales as a proportion of overall sales for the VAT unregistered population** in the 16 different economic sectors², to help ensure the correct amount of VAT is paid to the EU, as well as inform other aspects of HMRC tax policy making. The 16 sectors were chosen as they are of specific interest to HMRC. A secondary aim of the research was to **provide estimates of the levels of EU trade within the VAT unregistered business population**, particularly the percentage of EU sales as a proportion of overall business sales, so HMRC can better understand which businesses may be affected by the EU digital strategy and therefore may need future support.

1.2 Methodology

In order to meet the research objectives, the research focused on a representative sample of VAT unregistered businesses with a turnover of £8,000 to £83,000 in 16 industry sectors³. Businesses were selected from HMRC administrative data⁴. The research comprised a random probability telephone survey of 2,004 VAT unregistered businesses. Questionnaire development for the survey was informed by ten cognitive interviews and a small-scale pilot. Fieldwork for the survey took place between 10 October and 25 November 2016. Interviews were conducted with the business owner or the person in the business responsible for business and financial decision making. The average interview length was 11 minutes. The response rate was 40% which is consistent with other business surveys conducted by Ipsos MORI for HMRC.

1.3 Interpretation of findings

This report only comments on sub-group differences that are statistically significant at the 95% level of confidence. Statistical significant calculations were carried out based on the effective sample size - that is the sample size once the effect of design and non-response weighting is taken into account. Throughout the report, findings in charts marked with

¹ Businesses must register for VAT if their taxable turnover is more than £83,000 (the 'VAT threshold') in a 12-month period. Businesses must also register if they only sell goods or services exempt from VAT but purchase those for more than £83,000 from EU VAT registered suppliers. In April 2017 the VAT registration threshold will rise to £85,000 as announced in the Spring Budget 2017.

² A full list of the sectors can be found in Appendix 2.

³ £8,000 is the EU wide threshold mentioned in paragraph 2 of section 1.1 - businesses with a turnover under £8,000 were screened out as they were of less interest to the study.

⁴ As the data was drawn from 2013/14, the information was verified at the start of the survey to ensure businesses were eligible for the survey.

an asterisk (*) are based on small base sizes of less than 100 interviews. The following symbol (~) represent a result of less than half a per cent, but more than zero.

2 Executive Summary

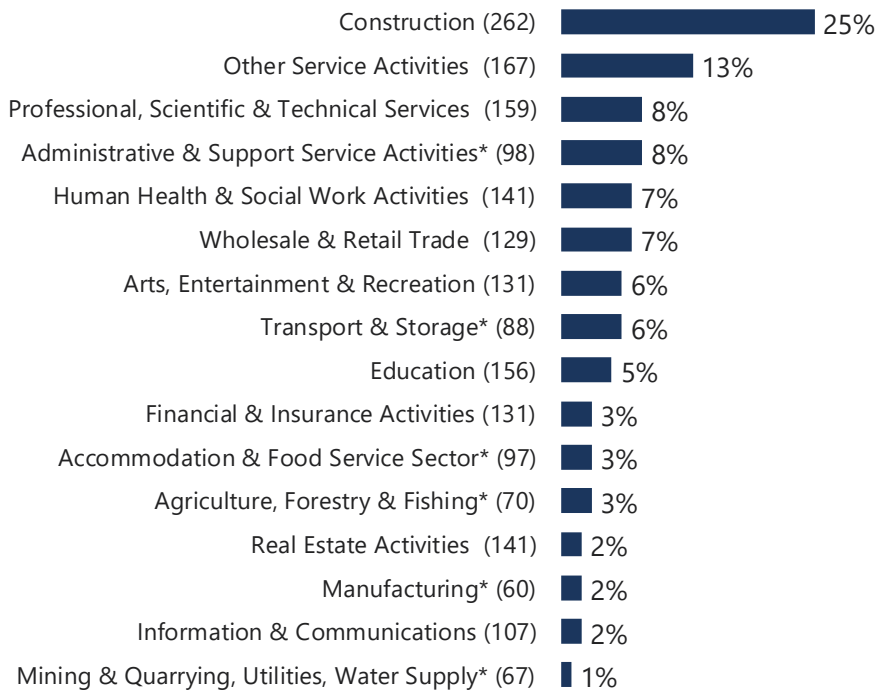
Background and methodology

HM Revenue and Customs commissioned Ipsos MORI to conduct quantitative research into the trading patterns of VAT unregistered businesses to provide an accurate estimation of the percentage of B2C sales and the levels of EU trade within this population. The research focused on VAT unregistered businesses with a turnover of £8,000 to £83,000. A random probability telephone survey of 2,004 businesses was undertaken, informed by 10 cognitive interviews and a small-scale pilot.

Profile of VAT unregistered businesses

The businesses that took part in the research covered 16 industry sectors. Within the unregistered population, a quarter (25%) were in the Construction sector, followed by 13% in 'Other service activities'. Regional variations were apparent. For example, the share of Construction businesses was higher than average in Wales (39%) and East Anglia (33%); and there were twice as many Arts, Entertainment and Recreation businesses in London than across the UK as a whole (12% compared with six per cent).

Figure 2.1: Industry sector



* denotes a small base size of less than 100; numbers in brackets denote unweighted base size

The majority of businesses were nano businesses with no employees other than the respondent (84%). Thirteen per cent of businesses had one or two employees and only three per cent had at least three employees. Variations were again evident by sector where businesses in the Arts, Entertainment and Recreation (92%) sector were more likely to have no employees.

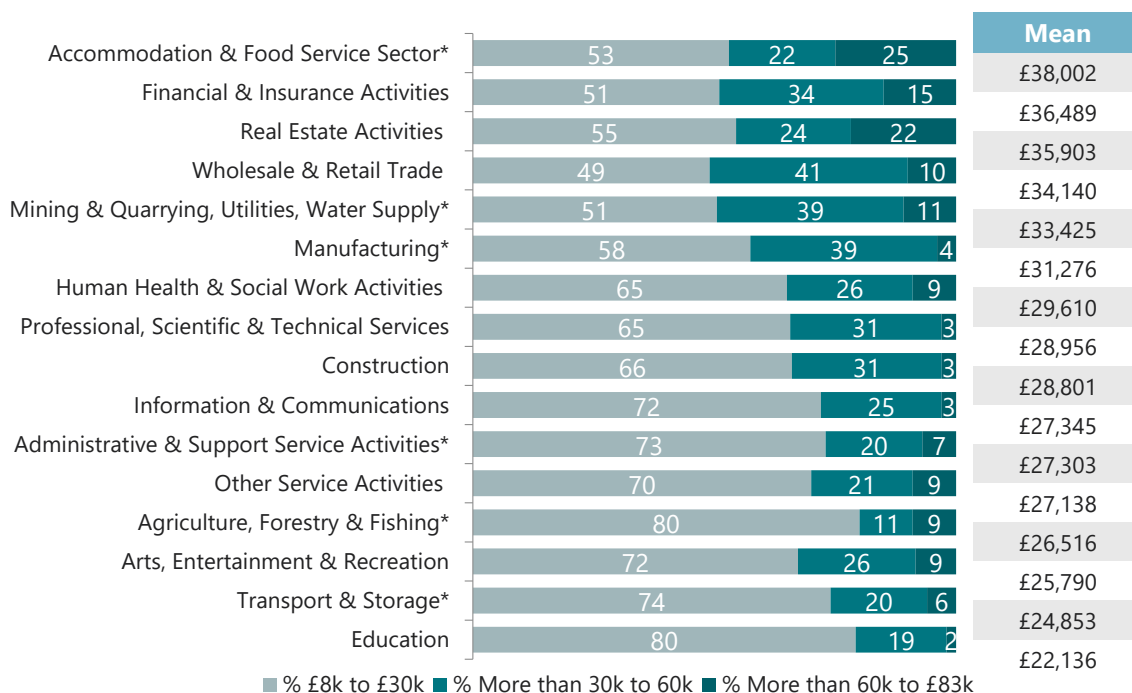
Almost nine in ten businesses were sole traders or partnerships (88%); the remainder were companies. Sole traders were more likely to have made mainly B2C transactions (57%), and did not use accountants (30%). Businesses in the East Midlands (19%) were more likely to be companies, and there was a higher proportion of sole traders and partnerships in the South East (93%). Those in the Construction (27%) and Other Service Activities (14%) sectors were more likely to be sole traders or partnerships, and those in the Professional, Scientific and Technical (14%), Administrative and Support Services (14%), Financial and Insurance (10%) and Real Estate (10%) sectors were more likely to be companies.

Half of businesses (52%) had been trading for more than 10 years, three in ten (31%) had been trading between five and ten years and one in six (17%) for under five years. Again there were some sectoral variations. For example, businesses in the Construction sector were most likely to have been trading longer (30% operating at least 20 years compared with 23% overall). In contrast, the Professional, Scientific and Technical Activities sector had a higher proportion of businesses that had more recently set up (25% operating less than five years). The only regional difference was businesses in the East Midlands were younger than average – only 39% were trading for more than 10 years, compared with 52% overall.

Business inputs and outputs

Two-thirds of businesses had a turnover of between £8,000 and £30,000 in the last financial year (66%). Just over a quarter (27%) had a turnover of more than £30,000 and up to £60,000 and only seven per cent had a turnover over £60,000 and up to the VAT threshold (£83,000). For most sectors, the breakdown of turnover was consistent with the overall results. The exceptions were the Education sector (£22,136) which had the lowest average turnover, Wholesale and Retail (41%) which had a higher proportion of businesses with a turnover of more than £30,000 and up to £60,000, and the Accommodation and Food Service Activities (£38,002), Financial and Insurance Activities (£36,489), and Real Estate Activities (£35,903) sectors which had the highest average turnover.

Figure 2.2: Turnover in the last financial year by sector



* denotes a small base size of less than 100

Base: Mining and Quarrying: Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

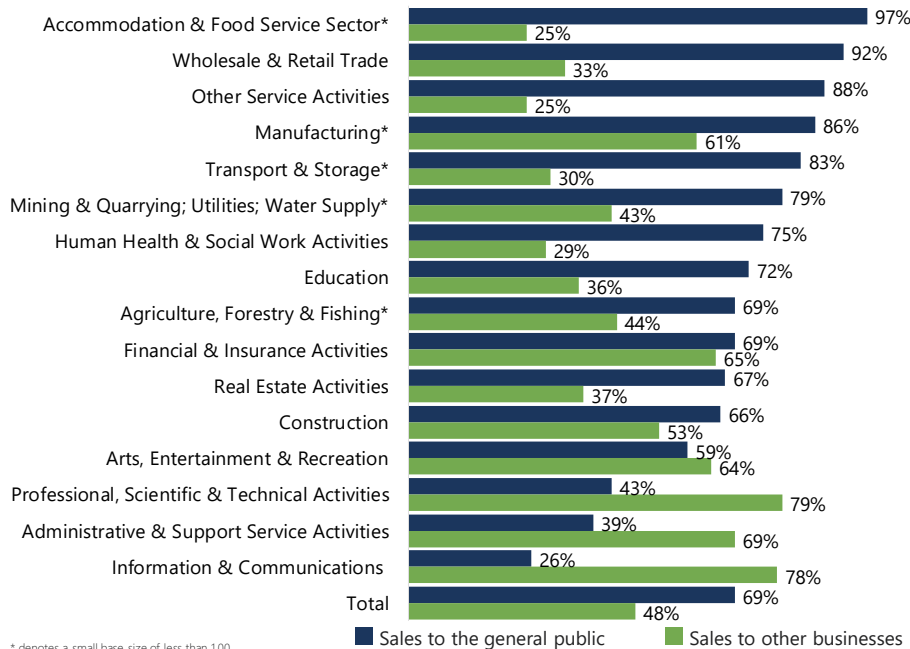
Businesses were asked their total costs of purchasing overhead items used in the production of goods or services⁵. Total costs were generally low among VAT unregistered businesses: 46% had costs up to £5,000 and only 14% had costs of more than £15,000. As for turnover, there were sectoral variations in purchasing costs. Businesses in the Mining and Quarrying, Utilities and Water Supply (£19,154) sectors were most likely to have the highest costs and businesses in the Information and Communications (£5,722) and Education (£5,834) sectors had the lowest average costs.

Business inputs and outputs also varied by agent usage and the method of accounting for sales and purchases. For example, businesses with a turnover of more than £30,000 up to £83,000, and higher purchasing costs of more than £15,000, were more likely to use a computerised software package (18% and 21% respectively compared with 14% overall).

Trading practices

Almost half (48%) of VAT unregistered businesses had made sales to other businesses in the last financial year, and seven in ten (69%) had sold goods or services to the general public; in total, around a fifth (22%) of businesses had made sales to both businesses and the general public in the last year. Looking across the sectors, those that traditionally serve the general public were more likely to have a higher proportion of B2C sales (for example, Accommodation and Food (97%), and Wholesale and Retail Trade (92%)). Businesses which are more professionally focused or office based did more trade with other businesses (for example, Professional, Scientific and Technical Activities (79%) and Information and Communications (78%)).

Figure 2.3: Type of sales made by sector



Base: Mining and Quarrying: Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

⁵ Businesses were asked to exclude wages and salaries, PAYE and National Insurance contributions, money taken out of the business, loans, dividends and gifts of money, insurance claims, Stock Exchange dealings, MOT certificates, motor vehicle licence duty and local authority rates.

Nearly all (98%) VAT unregistered businesses made sales to customers in the UK in the last financial year. A minority sold goods and services to other EU countries or the rest of the world (seven per cent each). In total, one in ten businesses (nine per cent) traded abroad, although only one per cent reported making sales only outside of the UK. Some sectors were more likely to trade internationally (for example 23% of Wholesale and Retail sector businesses sold goods or services to other EU countries compared with only two per cent of businesses in the Construction sector). Businesses that expected to grow in the next 12 months were also more likely to trade in this area (12%). However, among all VAT unregistered businesses that traded internationally, the largest proportion of their turnover was still generated through sales in the UK.

Within the EU, France (64%), Germany (54%), Italy (35%) and Spain (32%) were the most frequently mentioned countries VAT unregistered businesses made sales to in the last financial year; in the rest of the world most sales were made to English speaking countries including the United States (73%), Australia (42%), Canada (26%) and New Zealand (13%). VAT unregistered businesses that sold goods and services in the EU had been trading for a similar amount of time in this area, as they had been trading overall. Businesses that sold goods and services to the rest of the world, however, tended to have more recently started trading with these non-EU countries.

A little over half of VAT unregistered businesses trading in other EU countries made sales to the general public (55%); around half made sales to other businesses (49%). Therefore, compared with the overall findings, the proportion of businesses selling to the general public was significantly lower in this area. Of businesses that traded in other EU countries in the last financial year, seven in ten (70%) sold services specifically in the EU, and less than half (42%) sold goods in this particular area. Overall, six per cent of VAT unregistered businesses trading in the EU sold digital services to the general public. A similar pattern emerged when looking at sales to countries outside of the EU.

The vast majority of VAT unregistered businesses reported they had not purchased any overhead items used in the production of goods or services for their business from other EU countries or non-EU countries in the last financial year (90% and 91% respectively). Businesses that traded internationally were more likely to have incurred purchasing costs from other countries (for example 36% of businesses that traded in other EU countries), as were businesses with a higher turnover (13% with a turnover of £40,000+ incurred costs from other EU countries) and those that mainly traded with other businesses (11%). The Information and Communications (17%), Manufacturing (16%) and Wholesale and Retail (14%) sectors also had a significantly higher proportion of businesses that purchased goods and services from other businesses in the EU.

Accounts and record keeping

Seven in ten businesses used an accountant or tax advisor for any of their tax affairs (72%)⁶. The use of an agent was higher among several groups, including companies (86%), those with a higher input and output costs (83%), businesses that traded mainly B2C (76%) and employers (86%). However, businesses that traded internationally were less likely to use an agent (61% that sold to other EU countries compared with 72% overall).

The most common method for record keeping among VAT unregistered businesses was manual books and paper records (63%). Four in ten (40%) used manual electronic records and only 14% used a computerised software package. The method of record keeping again varied by trading status and whether the business mainly made sales to the general public or other businesses. Those that traded only in the UK (65%) were more likely to use manual paper records, whereas

⁶ The question did not specify whether accountants or tax advisors were paid so could include paid and unpaid agents.

a higher proportion of those that traded in the EU (59%) or the rest of the world (64%) used manual electronic records (e.g. Excel spreadsheets).

Among businesses that sold to both the general public and other businesses, only a minority said they reported on these groups separately in their accounts (13%). The same applied to businesses that made sales to customers in the UK, as well as internationally; only ten per cent reported separating out their sales by different areas.

Business performance

Two in five VAT unregistered businesses (43%) reported their turnover had remained stable over the last two financial years (2014/15 and 2015/16). A third reported growth (31%) and a quarter said their turnover had declined (24%). Those that traded in the rest of the world (45%) were significantly more likely to have grown between the last two financial years.

Table 2.1: Financial performance

	Overall	Traded internationally
<i>Base</i>	<i>(2,004)</i>	<i>(186)</i>
Grown between 14/15 - 15/16	31%	41%
Grown by 20% or more	8%	17%
Grown by less than 20%	22%	23%
Stay around the same	43%	36%
Declined between 14/15 - 15/16	24%	23%
Declined by 20% or more	13%	15%
Declined by less than 20%	10%	7%
Don't know	4%	2%

Of the businesses that traded internationally and had grown, around two-thirds (65%) said that this was due to sales in the UK; only four per cent said it was due to sales in the EU and one in six (16%) said it was due to sales in the rest of the world. A significant minority (15%) did not know where the growth came from. A similar pattern was evident among those that had declined, with a greater proportion (29%) unsure of the source of the decline.

Looking towards the next 12 months, half of VAT unregistered businesses expected their turnover to stay the same (51%). Again, on balance, more expected to grow than decline (27% compared with 15%). VAT unregistered businesses that traded internationally were more optimistic about future growth. For example, among those that sold goods and services in the EU 45% expected to grow compared with 26% that made sales to customers in the UK only).

Among businesses that expected to grow, a third planned to do this by moving into new markets (33%). Most expected to move into new markets in the UK only (74%), although a significant minority expected to increase sales through trading with the EU (14%) or other countries (16%).

A hypothetical question was posed to businesses to understand how they would react to being VAT registered. Businesses were asked to consider whether they would make any changes to their prices as a result of charging VAT on the goods and services they sold, bearing in mind the VAT they could reclaim and their market competition. Six in ten businesses (58%) said they would increase prices to cover all or some of the amount of VAT charged; three in ten (29%) would keep the prices the same. Two per cent would reduce their prices. Overall, one in ten (10%) did not know what they would do if they became VAT registered. The expected response to registering for VAT was consistent among most groups.

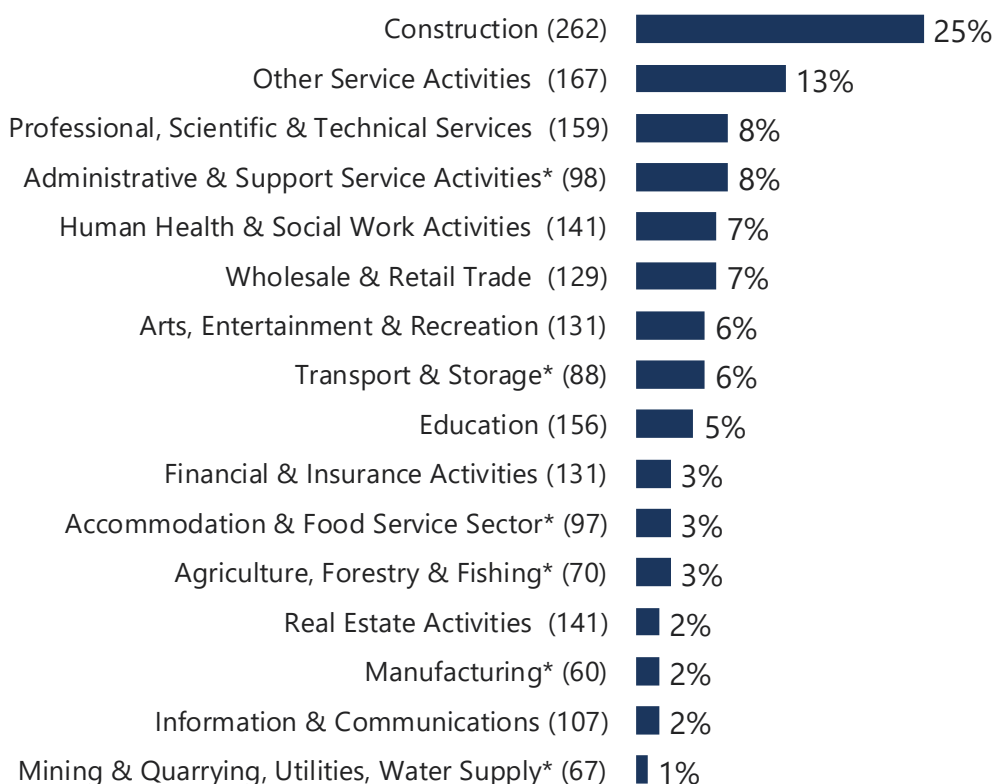
3 Profile of VAT unregistered businesses

This chapter sets out the key characteristics of the VAT unregistered businesses in terms of their sector, number of employees, trading status and length of time trading. This provides contextual information on the types of businesses that participated in the study. Businesses in certain sectors were purposively over-represented to make up for their relatively low incidence within the representative population as specific sector information was of interest to meet the research objectives.

3.1 Sector

The businesses that took part in the research covered 16 industry sectors. A quarter (25%) of businesses in the survey were in the Construction sector, followed by 13 per cent in 'Other Service Activities'⁷. A full breakdown is provided in Figure 3.1⁸.

Figure 3.1: Industry sector



* denotes a small base size of less than 100; numbers in brackets denote unweighted base size

The sectoral distribution was broadly consistent by number of employees – a notable exception was 'Other Service Activities' (41% with at least three employees were in this sector compared with 13% overall). Regional variations were also apparent. For example, the share of Construction businesses was higher than average in Northern Ireland (58%), Wales (39%), East Anglia (33%) and Yorkshire (33%); the proportion of Arts, Entertainment and Recreation businesses was higher

⁷ Other service activities covered a variety of service businesses such as hairdressers, funeral parlours and trade unions.

⁸ This is the distribution of businesses by sector within the survey. We are unable to make comparisons to the actual population as this information is not available.

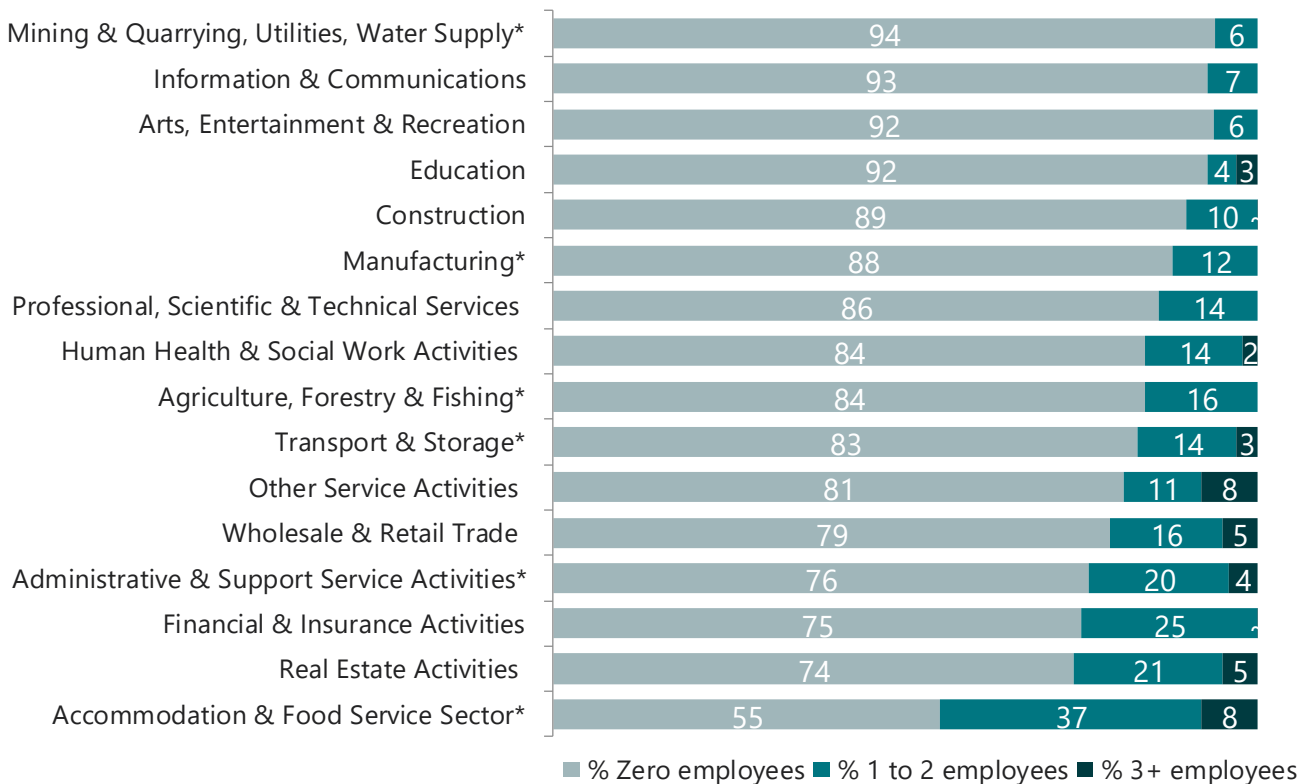
than average in London (12%); there was also a higher proportion of Manufacturing businesses in the North East (six per cent) and West Midlands (five per cent); and Agriculture, Forestry and Fishing in the South West (five per cent).

3.2 Number of employees

The majority of businesses were nano businesses with no employees other than the respondent (84%). Thirteen per cent of businesses had one or two employees and only three per cent had three or more employees.

Businesses in the Information and Communication and Arts, Entertainment and Recreation sectors were more likely to have no employees; businesses in the Accommodation and Food Service and Financial and Insurance Activities sectors were more likely to have one or two employees. The Accommodation and Food Service and Other Service Activities sectors were most likely to contain larger businesses with three or more employees (see Figure 3.2 for a full breakdown).

Figure 3.2: Size of business by sector



* denotes a small base size of less than 100

Base: Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

3.3 Trading status

The majority of businesses in this research were sole traders or partnerships (88%); the remainder were companies (12%).

Sole traders/ partnerships were more likely to:

- Be well established (53% trading for more than 10 years compared with 40% of companies).

- Be nano businesses (87% compared with 61% companies).
- Have mainly B2C transactions (57% compared with 42% companies).
- Have low input costs (49% between £1 and £5000 compared with 37% companies).
- Not use accountants (30% compared with 14% companies).
- Use manual paper accounts (65% compared with 44% companies).

3.4 Length of time trading

Half (52%) of businesses had been trading for more than 10 years, three in ten (31%) had been trading between five and ten years, and one in six (17%) for under five years.

There were some sectoral variations:

- Businesses in the Construction sector were most likely to have been trading longer (30% operating at least 20 years compared with 23% overall).
- Those in the Education and Other Service Activities sectors were also more likely to have older businesses (64% and 60% respectively trading over 10 years).
- The Professional, Scientific and Technical Activities sector had a higher proportion of businesses that had more recently set up (25% operating less than five years).
- The only regional difference was businesses in the East Midlands were younger than average – only 39% had been operating for more than 10 years, compared with 52% overall.

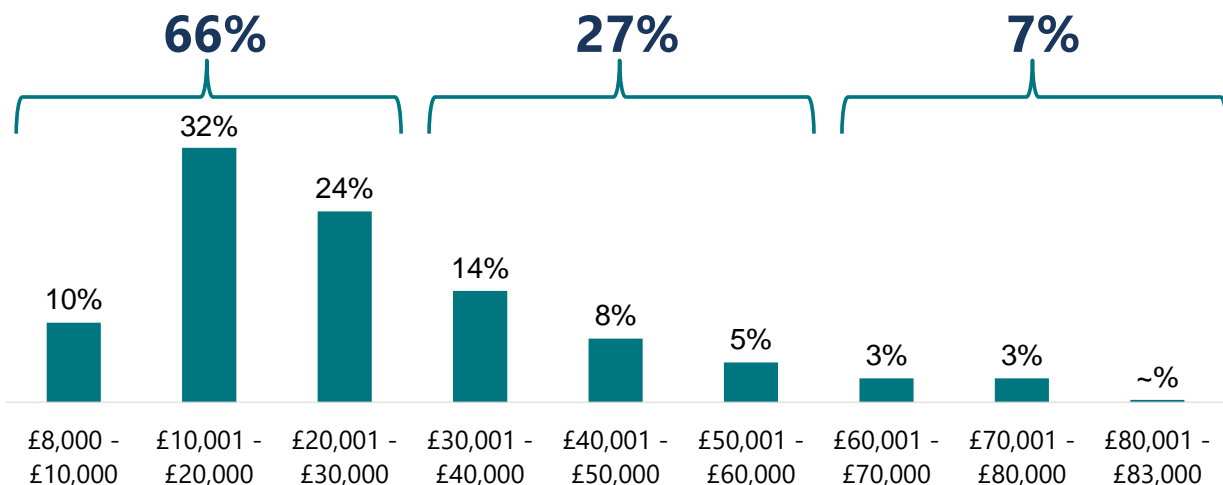
4 Business inputs and outputs

This section sets out business turnover and purchasing costs in the last financial year (2015/16). This was required to ensure businesses were in scope of the survey (i.e. with a turnover of £8,000 to £83,000), to estimate the value of final sales to the general public and to estimate cost to turnover ratios in different sectors. Turnover is the amount of money taken by a business from all sales of goods and services, before any deductions. Purchasing costs (also known as 'input costs') are overhead items used in the production of goods and services. In the survey, businesses were asked to exclude a number of items from their costs: wages and salaries, money taken out of the business, insurance claims, Stock Exchange dealings, MOT certificates, motor vehicle licence duty and local authority rates. These were excluded to allow for comparability with the purchasing costs question on VAT returns.

4.1 Turnover

Businesses were asked to give their turnover in the last financial year; if the business could not provide a figure they were asked to select a band which was closest. Combining the actual and banded responses, two thirds (66%) of businesses had a turnover of between £8,000 and £30,000 in the last financial year, just over a quarter (27%) had a turnover of more than £30,000 and up to £60,000, and less than one in ten (seven per cent) had a turnover over £60,000 and up to the VAT threshold of £83,000. A breakdown is shown in Figure 4.1 below.

Figure 4.1: Turnover in the last financial year



Base: All unregistered businesses with turnover £8k-£83k (2,004)

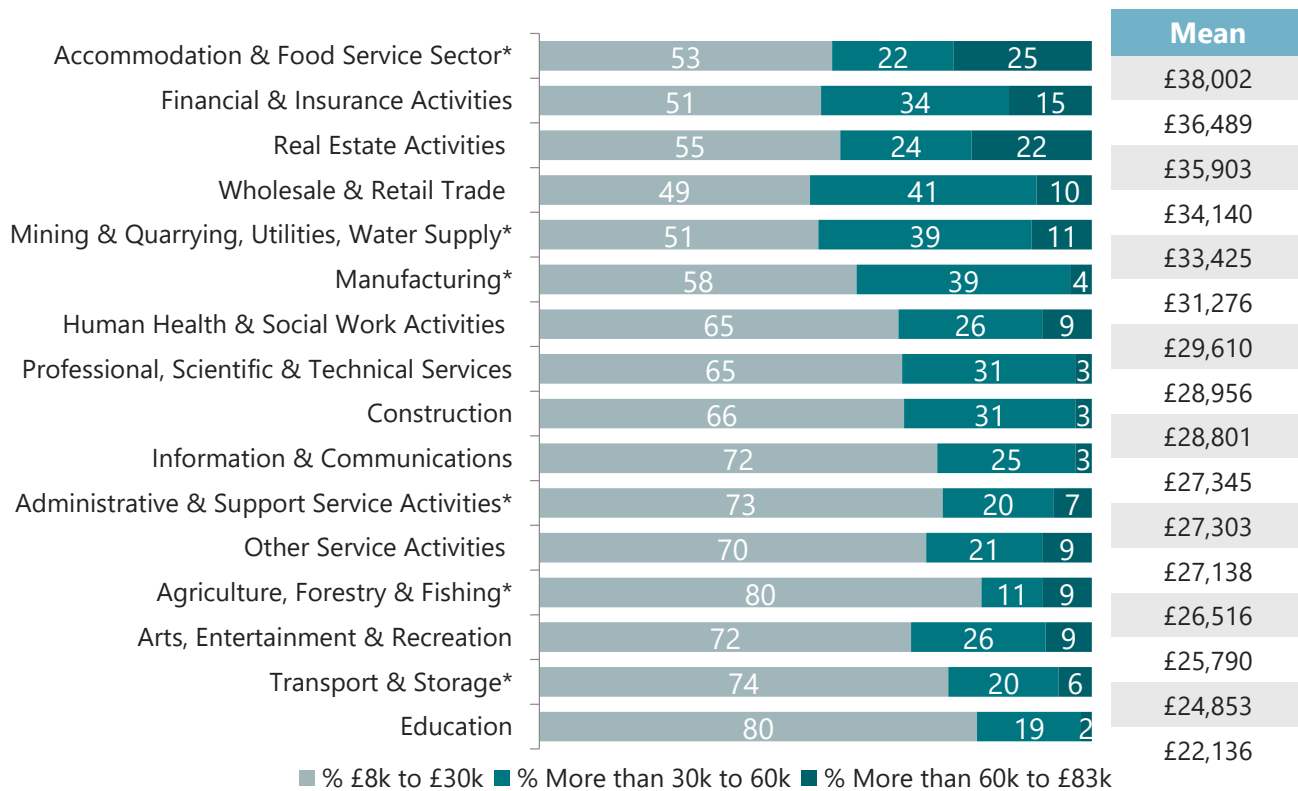
For most sectors, the breakdown of turnover was consistent with the overall results. The exceptions, as shown in Figure 4.2, were the:

- Education sector where four in five businesses (80%) had a lower turnover of between £8,000 and £30,000 - this sector also had the lowest average turnover of all the sectors (£22,136)⁹.
- Wholesale and Retail sector where two in five (41%) had a turnover of more than £30,000 up to £60,000.

⁹ Average turnover was derived by taking the mean of the actual figure given or the midpoint of banded responses.

- Accommodation and Food Service Activities (25%), Real Estate Activities (22%) and Financial and Insurance Activities (15%) had the highest proportion of businesses with a turnover of between £60,000 and £83,000, and subsequently the highest average turnovers.

Figure 4.2: Turnover in the last financial year by sector



* denotes a small base size of less than 100

Base: Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

On the whole, there were few differences by turnover between businesses that traded mainly B2B or mainly B2C. The only significant difference found was that a higher proportion of businesses that traded mainly B2C had a turnover of more than £60,000 and up to £83,000 (eight per cent compared with four per cent of businesses that traded mainly B2B)¹⁰.

Seven in ten (70%) businesses that accounted for sales and purchases with paper books and records had a turnover between £8,000 and £30,000; this was significantly higher than businesses that used other methods of bookkeeping (62% that used manual electronic records and 58% that used software). There is a relationship between the method of record keeping and whether businesses were able to provide an actual figure for turnover; businesses that account for sales and purchases with a computerised software package or manual electronic records were more likely to give a figure than those that use paper records (83%, 81% and 76% respectively).

Businesses that did their own tax administration were more likely to have a lower turnover (74% had a turnover between £8,000 and £30,000 compared with 63% with an accountant). Use of accountants was more prevalent among businesses with a higher turnover of more than £30,000 and up to £83,000 (37% had a turnover above £30,000 compared with 26%

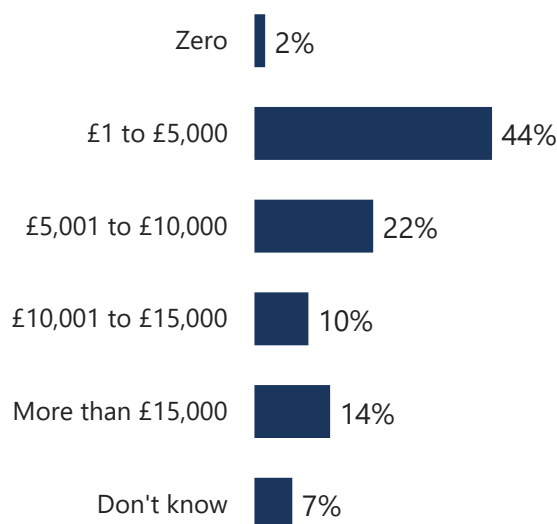
¹⁰ Selling 'mainly to other businesses' is businesses that make most (i.e. more than 60%) of their sales to other businesses. Selling 'mainly to the general public' is businesses that make most (i.e. more than 60%) of their sales to the general public.

without an accountant). The role accountants play in tax administration varies considerably, as shown in other research Ipsos MORI has undertaken for HMRC: smaller businesses with less experience and familiarity with tax often relied on accountants, giving them full responsibility for compiling, checking and submitting returns, based on invoices and receipts provided by the business.

4.2 Total costs of purchasing goods or services

Businesses were asked to give the total costs to their business of purchasing overhead items used in the production of goods or services¹¹; if the business could not provide a figure they were asked to select a band which was closest. As shown in Figure 4.3, total costs were generally low among VAT unregistered businesses: 46% had costs of up to £5,000 and only 14% had costs of more than £15,000 in the last financial year.

Figure 4.3: Purchasing costs in the last financial year



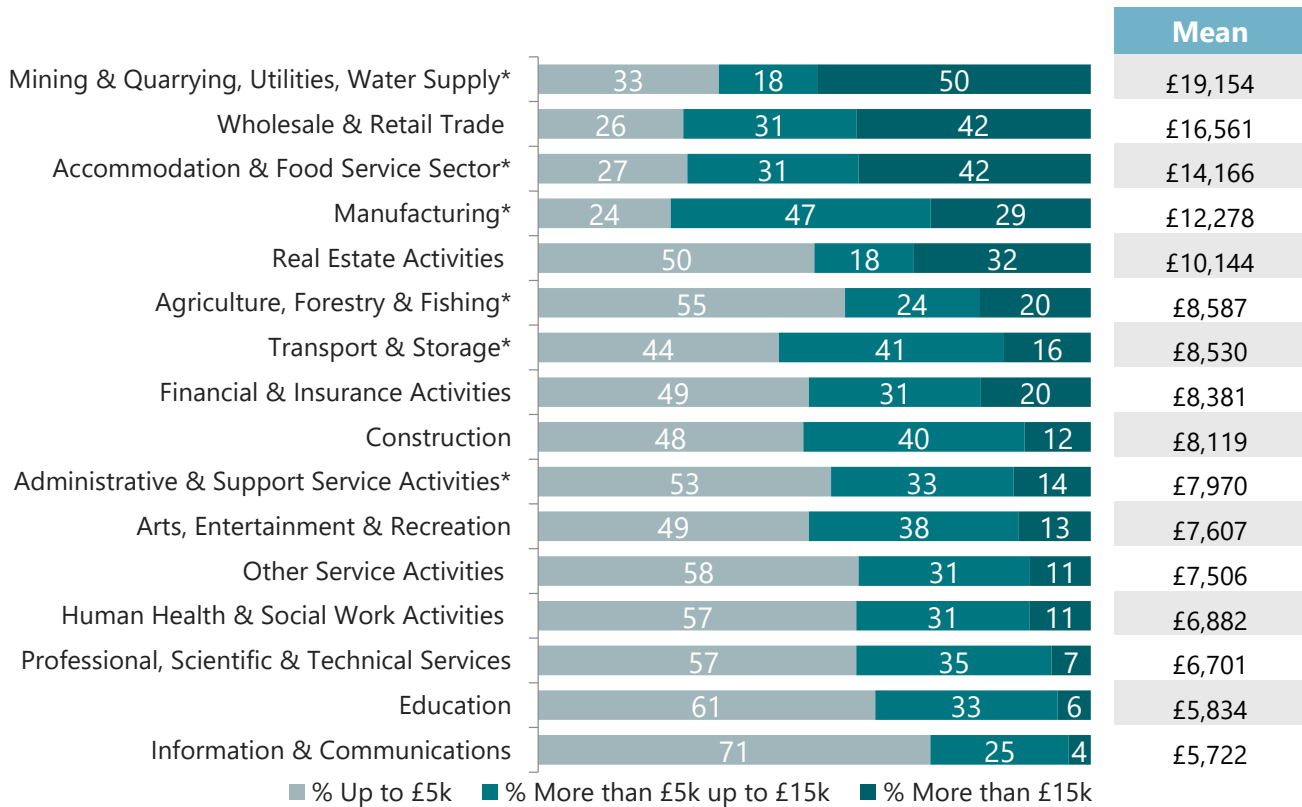
Base: All unregistered businesses with turnover £8k-£83k (2,004)

As for turnover, businesses that were able to provide an actual figure were more likely to account for sales and purchases with a computerised software package or manual electronic records rather than use paper records (65%, 61% and 57% respectively).

There were sectoral variations in purchasing costs, as shown in Figure 4.4:

- Businesses in the Mining and Quarrying, Utilities and Water Supply sector were most likely to have the highest costs (£19,154 on average), followed by Wholesale and Retail (£16,561) and Accommodation and Food Service (£14,166).
- Businesses in the Information and Communications (£5,722) and Education (£5,834) sectors had the lowest average costs.

¹¹ As set out earlier, businesses were asked to exclude a number of items from this figure: wages and salaries, PAYE and National Insurance contributions, money taken out of the business, loans, dividends and gifts of money, insurance claims, Stock Exchange dealings, MOT certificates, motor vehicle licence duty and local authority rates.

Figure 4.4: Purchasing costs by sector

* denotes a small base size of less than 100

Base: Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

There were also some key differences by whether the business mainly made sales to other businesses or the general public. For example, businesses that mainly sold goods and services to the general public were more likely to have costs of more than £15,000 (19% compared with nine per cent of businesses that mainly sold to other businesses). Furthermore, those that grew in the last financial year had higher costs (20% more than £15,000 compared with 11% that stayed the same and 14% that declined), as did those that used a software package for their accounts which as previously noted tended to be larger VAT unregistered businesses (23% compared with 16% manual electronic and 13% paper records). Companies were significantly more likely than sole traders or partnerships to have costs of more than £15,000 (22% compared with 13%); again possibly related to this (as companies were more likely to have employees), businesses with employees had higher costs (27% compared with 12% of businesses with no employees).

Table 4.1 shows the proportion of turnover by input costs. For most VAT unregistered businesses, the cost of overhead items used in the production of goods or services was less than 30% of their turnover (57%). Three in ten (29%) had input costs between 30% and 70% of their turnover, and six per cent of businesses had high input costs above 70% of their turnover.

Table 4.1: Purchasing costs by turnover

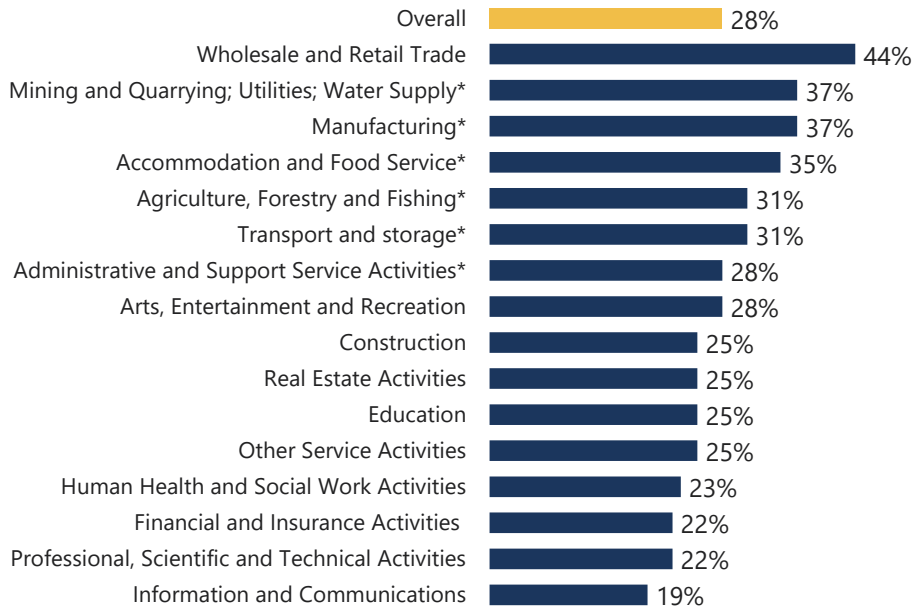
	Total
<i>Base</i>	<i>(1,871)</i>
Low proportion of turnover to purchasing cost (less than 30%)	57%
Medium proportion of turnover to purchasing costs (30% to 70%)	29%
High proportion of turnover to purchasing costs (more than 70%)	6%
Don't know	8%

Again, there were some key differences by whether the business had employees, mainly made sales to other businesses or the general public, and by financial performance:

- Businesses that remained the same size in the last financial year were more likely to have low input costs (61% compared with 56% that declined and 54% that grew).
- Nano businesses were also more likely to have low input costs (59% compared with 50% with employees).
- Those that mainly sold to other businesses had low input costs (68% compared with 49% B2C and 56% mixed).
- Businesses that mainly sold to the general public were more likely to have medium input costs (34% compared with 22% B2B).
- Businesses that declined in the last financial year had higher input costs (nine per cent compared with five per cent that stayed the same and seven per cent that grew).

There were also some key differences by sector as shown in Figure 4.5. For example, looking at costs as a proportion of turnover the Wholesale and Retail sector had the highest costs (44%) and the Information and Communications sector had the lowest costs (19%).

Figure 4.5: Costs as a proportion of turnover by sector

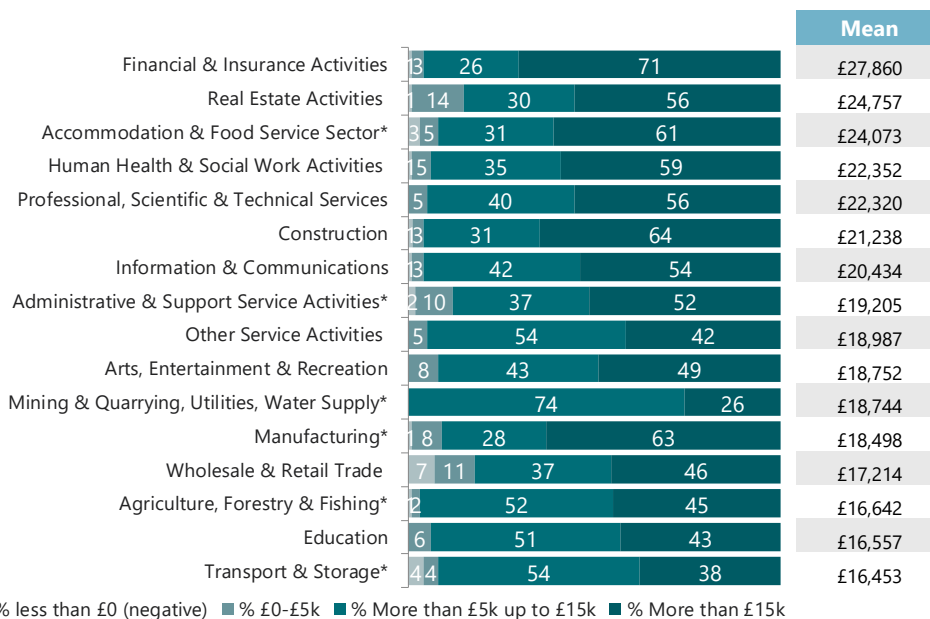


* denotes a small base size of less than 100

Base: Mining and Quarrying: Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

Figure 4.6 shows the 'Yield' for each sector which is the amount left over after costs have been subtracted from the turnover, providing a proxy figure for money earned. Businesses in the Financial and Insurance Activities sector yielded the highest amount (with an average of £27,860); the Transport and Storage sector had the lowest yield (£16,453).

Figure 4.6: Yield per sector (after costs subtracted from turnover)



■ % less than £0 (negative) ■ % £0-£5k ■ % More than £5k up to £15k ■ % More than £15k

* denotes a small base size of less than 100

Base: Mining and Quarrying: Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

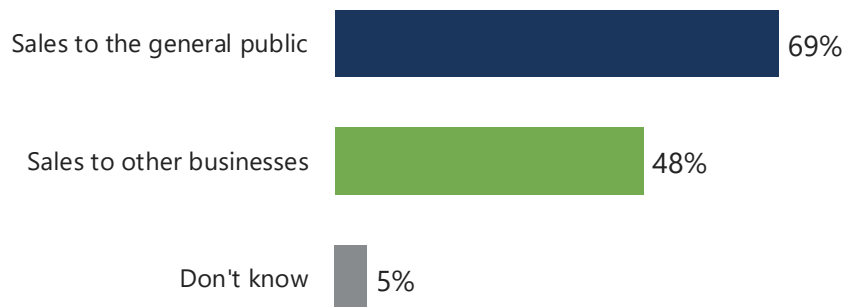
5 Trading practices

This section examines the trading practices of VAT unregistered businesses in the last financial year (2015/16), including the types of customers and location of sales. The research provides estimations of the percentage of B2C sales as a proportion of overall sales, as a whole and for each of the 16 sectors. It also explores the level of EU trade within the VAT unregistered business population, including the percentage of EU sales as a proportion of overall business sales, and the length of time businesses have been trading internationally.

5.1 Sales to other business and general public

Almost half (48%) of businesses made sales to other businesses in the last financial year, and seven in ten (69%) sold goods or services to the general public; in total, around a fifth (22%) of businesses made sales to both businesses and the general public in the last year. Among those that sold to both businesses and the general public, a third (32%) sold mainly to other businesses, around two-fifths (38%) sold mainly to the general public and a quarter (25%) sold a more even mix between the two.

Figure 5.1: Type of sales made in the last financial year

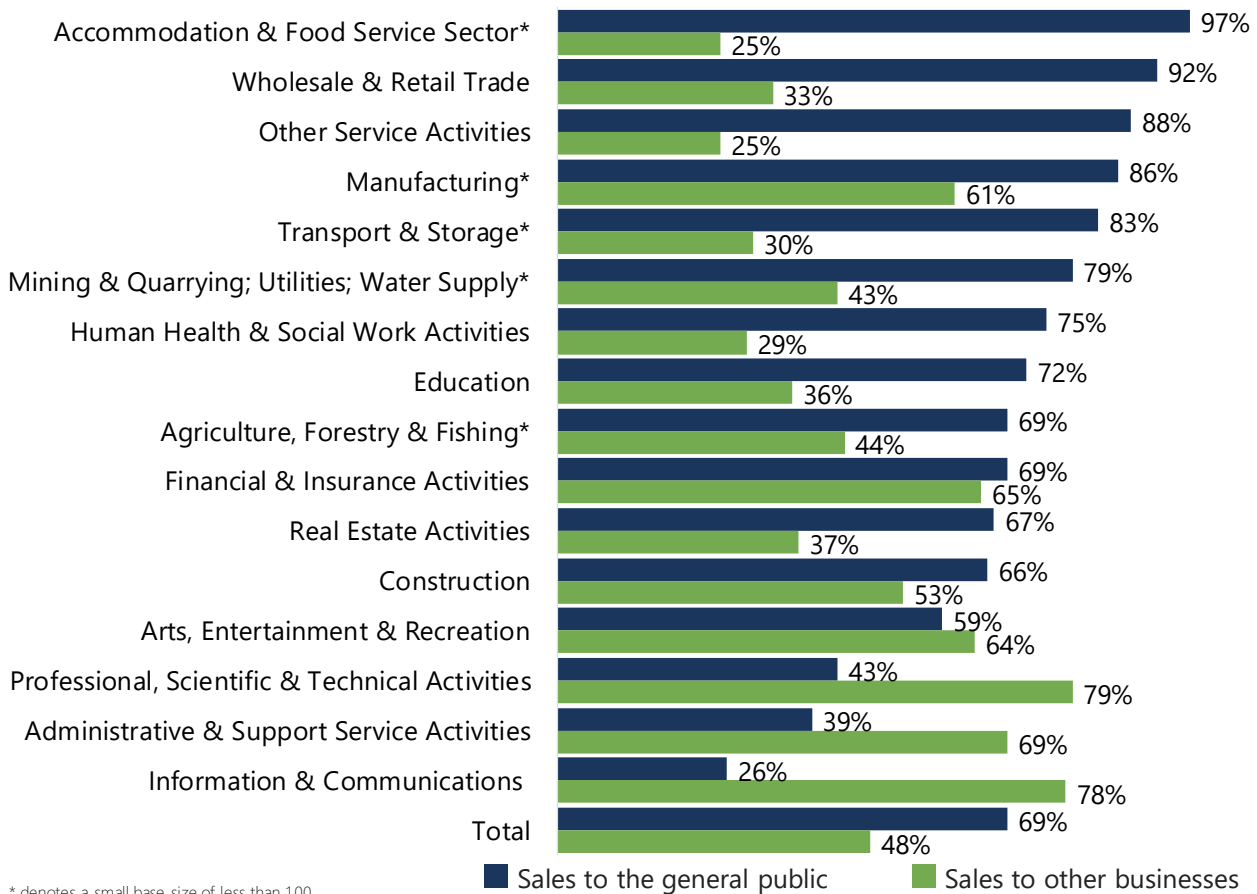


Base: All unregistered businesses with turnover £8k-£83k (2,004)

Looking across the sectors, businesses in those sectors that traditionally serve the general public were more likely to have a higher proportion of any B2C sales and a lower proportion of any B2B sales, whereas businesses in sectors that are more professionally focused or office based did more trade with other businesses¹². For example, Accommodation and Food services (97%) and Wholesale and Retail businesses (92%) had a significantly higher proportion of businesses making any sales to the general public, and lower levels of any sales to other businesses (25% and 33% respectively). The Professional, Scientific and Technical Activities (43%) and Information and Communications (26%) sectors had a lower proportion of businesses making any sales to the public, and a higher proportion selling to other businesses (79% and 78% respectively). One sector to buck this trend was Manufacturing, which recorded high levels of sales with other businesses (86%), as well as the general public (61%)¹³.

¹² This analysis is comprised of businesses that have made any sales to the general public (B2C), and businesses that have made any sales to other businesses (B2B).

¹³ The number of interviews conducted with businesses in the Manufacturing sector was small (61) and the majority of respondents in this sector were sole traders (53) which may explain why this group records high levels of B2C as well as B2B sales. Businesses in the manufacturing sector were diverse, and included furniture makers, a curtain seamstress, a wedding cake baker, a bicycle manufacturer and a laser cutting business.

Figure 5.2: Type of sales made by sector

* denotes a small base size of less than 100

Base: Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

Related to the sectoral variations, businesses in the North West were more likely than average to have made any sales to the general public (80%), while businesses in London were less likely (59%). Businesses in Scotland were also more likely than average to have made any sales to the general public (80%) and less likely than average to have sold to other businesses (35%).

Aside from sector and region, there were some key differences by length of trading, size of business, location of customers and trading status:

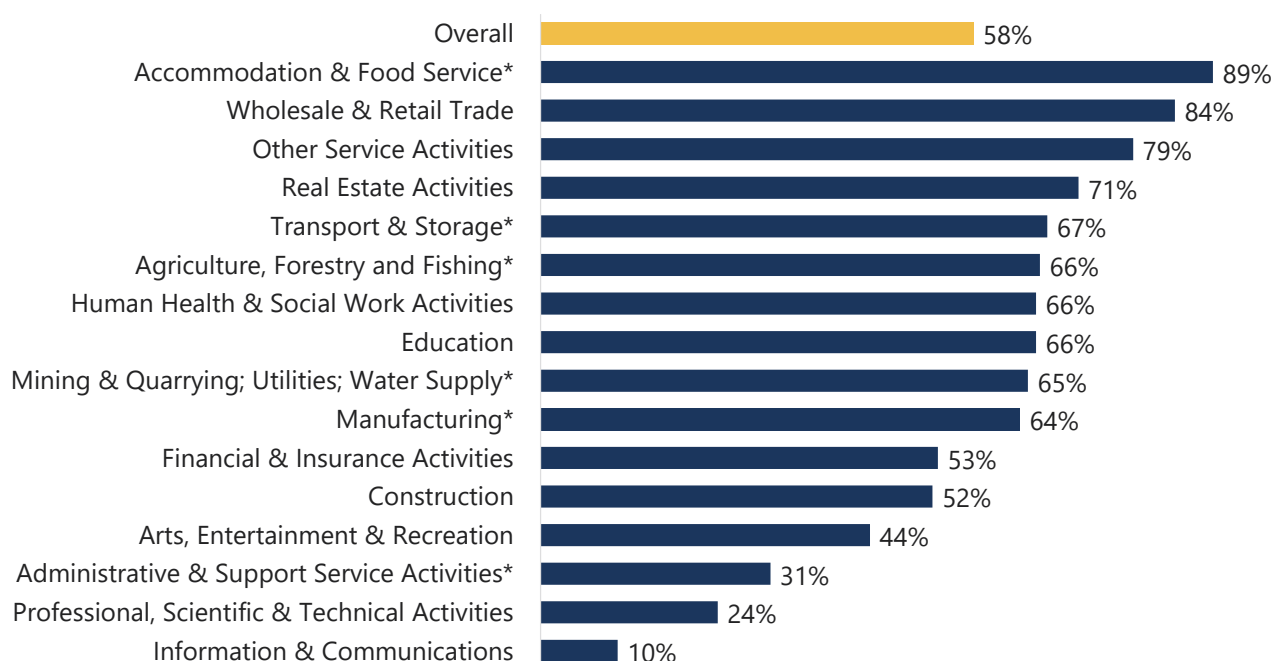
- Businesses that had been trading for more than 10 years were significantly more likely to trade with the public than those that had been trading for less than 5 years (73% compared with 61%).
- Larger businesses with three or more employees were also more likely to sell to the public (87% compared with 67% of nano businesses).
- Those with a turnover of between £20,000 and £60,000 were more likely to trade with other businesses than those with a turnover under or over this amount (54% compared with 41% each).
- Companies were significantly more likely to trade with other businesses than sole traders and partnerships (57% compared with 47%); other research Ipsos MORI has conducted for HMRC shows that some businesses will not

work with other businesses unless they are incorporated and it can be more difficult for sole traders to establish commercial relationships with companies¹⁴.

- Those that sold goods and services outside the UK were also more likely than average to trade with other businesses (rest of the world, 68%; EU, 63%).

Figure 5.3 shows the proportion of turnover that is sales to the general public by the 16 sectors. Businesses with a higher proportion of B2C sales (e.g. Accommodation and Food Service and Wholesale and Retail Trade) had a higher proportion of turnover from the general public, and those with a lower proportion of B2C sales had a lower proportion of turnover from the general public (e.g. Information and Communication, and Professional, Scientific and Technical Activities).

Figure 5.3: Proportion of turnover that is sales to general public by sector



* denotes a small base size of less than 100

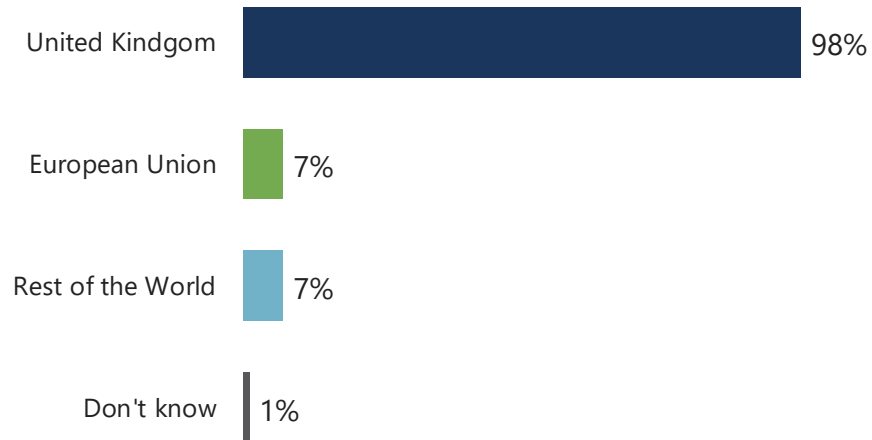
Base: Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

5.2 International trade

Nearly all (98%) VAT unregistered businesses trade goods or services in the United Kingdom, with nine in ten (90%) of all business trading exclusively in the UK. International trade was much less prevalent, with nine per cent overall reporting that they traded in either the EU or the rest of world. Specifically, seven per cent of businesses reported selling goods or services to customers in the EU, and the same proportion (seven per cent) selling to customers in the rest of the world. Among all VAT unregistered businesses, just one per cent report that they trade only internationally.

¹⁴ HMRC Research Report 317: Reasons behind incorporation

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/342335/HMRC_Research_Report_317_-_Reasons_behind_incorporation.pdf

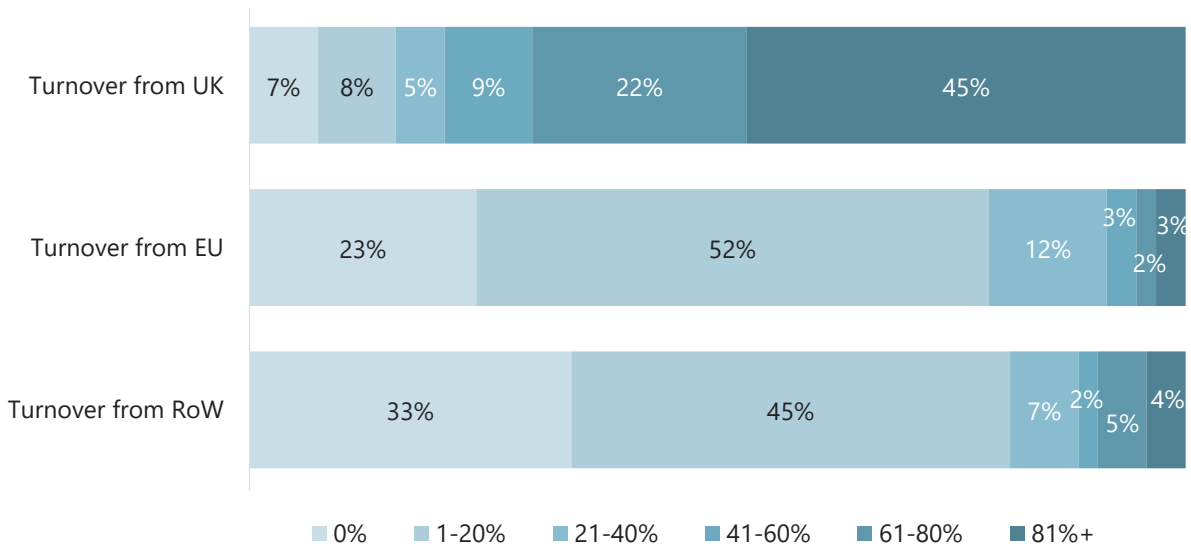
Figure 5.4: Location of customers in the last financial year

Base: All unregistered businesses with turnover £8k-£83k (2,004). Results sum to more than 100% as respondents could select more than one response at this question

B2B businesses were significantly more likely to sell goods or services to customers in the EU (10%) or in the rest of the world (nine per cent). Businesses that expected to grow in the next 12 months were also more likely to trade in these areas (12% EU and 10% rest of the world). Differences by sectors were also evident; for example, Accommodation and Food Services (22% EU, 23% rest of the world) and Wholesale and Retail (23% EU, 18% rest of the world) were significantly more likely to trade internationally than those in the Construction sector (two per cent EU, one per cent rest of the world). Given the geographical distribution of sectors, regional variations were also apparent. For example, businesses in the East Midlands were more likely to have sold to the EU (15%) and the rest of the world (15%), compared with seven per cent of businesses UK-wide for both markets. While four per cent of all businesses said they had sold in the UK, to EU countries and also to non-EU countries, 10% of businesses in the West Midlands had done this.

However, among VAT unregistered businesses that traded internationally, the largest proportion of their turnover was generated through sales in the UK rather than other countries¹⁵. Around two-thirds (67%) of these businesses reported that at least 61% of their turnover was generated in the UK, half (52%) reported that between 1%-20% of their turnover was from the EU and a similar proportion (45%) said between 1%-20% of their turnover was generated from the rest of the world. This is shown in Figure 5.5.

¹⁵ Sub-group analysis has not been reported on as the base size for this question is too small.

Figure 5.5: Location of source of turnover

Base: All unregistered businesses that trade internationally (205); 'Don't know' 0%.

Businesses that sold goods and services in the EU had been trading for a similar amount of time in this area, as they had been trading overall (see Table 5.1). Businesses that sold goods and services to the rest of the world, however, tended to have more recently started trading with other countries.

Table 5.1: Length of time trading

	Businesses trading in EU		Businesses trading in rest of the world	
	Trade overall (138)	Trade in EU (138)	Trade overall (131)	Trade in rest of the world (131)
Less than five years	25%	28%	20%	32%
Five to less than 10 years	29%	31%	39%	35%
Over 10 years	46%	41%	41%	32%

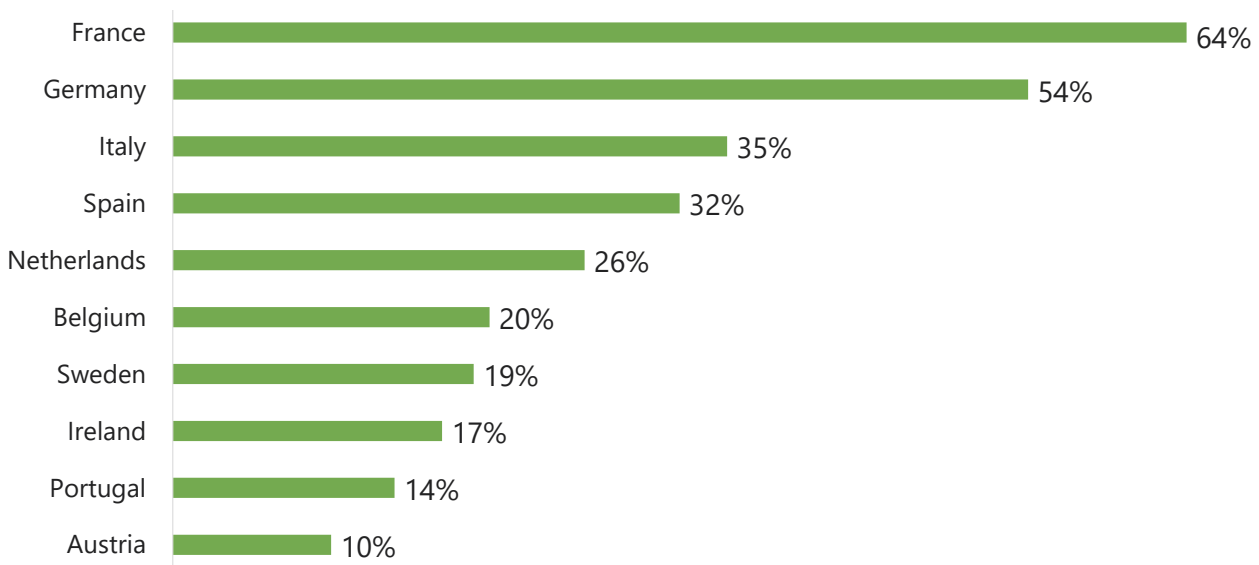
6 Trading in the European Union

This chapter examines the trading patterns of businesses that made sales in the EU, including the particular countries they traded in, whether goods and/or services were sold, and the total value of digital sales to consumers located in the EU. The research also estimates purchasing costs from this area. Please note that there are few subgroup differences due to the small base sizes; where significant differences exist they have been reported.

6.1 Trading locations

France (64%) and Germany (54%) were the most frequently mentioned EU countries in which businesses traded in the last financial year, followed by Italy (35%), Spain (32%) and the Netherlands (26%).

Figure 6.1: EU countries sold goods and services to in the last financial year



Base: All unregistered businesses who have sold goods or services in the EU for at least one year (139)

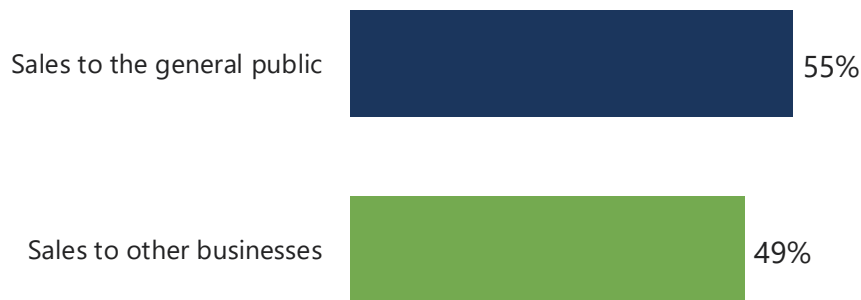
Businesses that also sold goods and services to non-EU countries were more likely to trade in Germany (70%), Italy (44%) and the Netherlands (37%).

6.2 Sales in the EU

6.2.1 Business and consumer trade

A little over half (55%) of businesses that traded in the EU in the last financial year made sales to the general public in this area; half of businesses (49%) made sales to other businesses.

Compared with the overall findings, the proportion of businesses selling to the general public was significantly lower in the EU (55% in EU and 69% overall), although there was no significant difference in the proportion of B2B sales (49% in EU and 48% overall). As seen in the previous chapter, businesses that operate in sectors which traditionally trade with other businesses were more likely to trade internationally, which partly explains the lower proportion of businesses that traded with the general public in the EU.

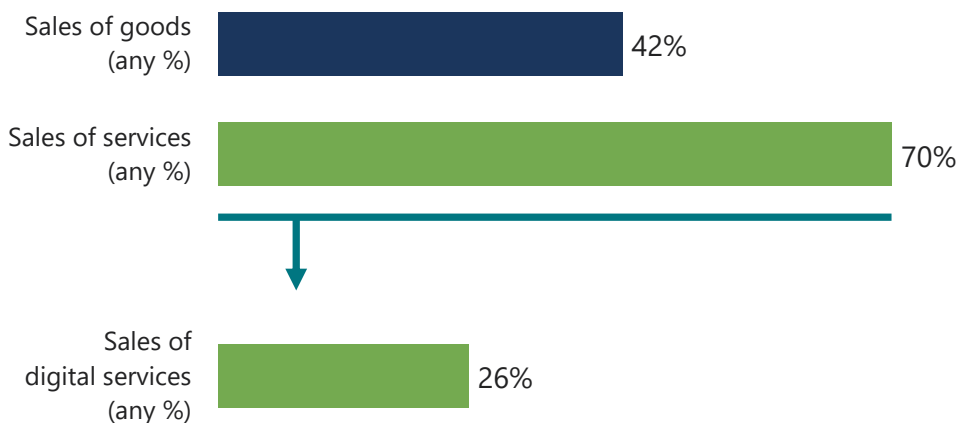
Figure 6.2: Type of sales made in the EU in the last financial year

Base: All unregistered businesses that traded in EU in last financial year (139)

Among businesses that traded in the EU, half (51%) made sales *only* to the general public in the EU, a slightly smaller proportion (45%) made sales *only* to other businesses and four per cent reported sales to other businesses *and* the general public.

6.2.2 Sales of goods and services

Of businesses that traded in the EU in the last financial year, seven in ten (70%) sold services specifically in the EU, and less than half (42%) sold goods in this particular area.

Figure 6.3: Sales of goods, services and digital services in the EU in the last financial year

Base: All unregistered businesses who sell goods and services, and trade in the EU (139); All business which sell services in the EU (45)

Businesses that made sales mainly to other businesses were significantly more likely to have sold services (93%) and significantly less likely to have sold goods (nine per cent). In contrast, those that made sales mainly to the public were significantly more likely to have sold goods (66%) and less likely to have sold services (53%). This suggests that a relationship exists between the type of product being sold (i.e. goods or services) and the type of customers (businesses or the general public).

Those with purchasing costs of over £5,000 were more likely to have sold goods in the EU (54% compared with 42% overall).

6.2.3 Sales of digital services in the EU

Businesses that sold services in the EU were asked if they had sold any digital services to the general public in the last financial year. One quarter (26%) reported that at least some of their sales were digital services to the general public; this represented around six per cent of all businesses that traded in the EU.

6.3 Costs of purchasing goods or services from the EU

Among all VAT unregistered businesses, nine in ten (90%) reported that they had not purchased any overhead items from the rest of the EU used in the production of goods or services for their business in the last financial year. Seven per cent reported costs between £1 up to £5,000, and only one per cent reported costs of more than £5,000.

Table 6.1: Purchasing costs from the EU in the last financial year

	Total
<i>Base</i>	<i>(2,004)</i>
£0 (zero)	90%
£1-£5,000	7%
£5,001+	1%
Don't know	2%

Businesses with a smaller turnover of £8,000 to £30,000 were more likely to have no costs from the EU (92%), as were those that mainly traded with the general public (92%) and those that sold to customers in the UK only (also 92%). Businesses in the Finance and Insurance (99%), Accommodation and Food services (98%) and Construction (94%) sectors were also more likely to have no costs from this area.

Those businesses that were significantly more likely to have incurred costs from the EU were businesses with higher turnovers of £40,000 to £83,000 (13%) and those which traded internationally (EU, 36%; rest of the world, 33%). The Arts, Entertainment and Recreation (21%), Information and Communications (17%) and Wholesale and Retail (14%) sectors also had a significantly higher proportion of businesses that purchased goods and services from other businesses in the EU.

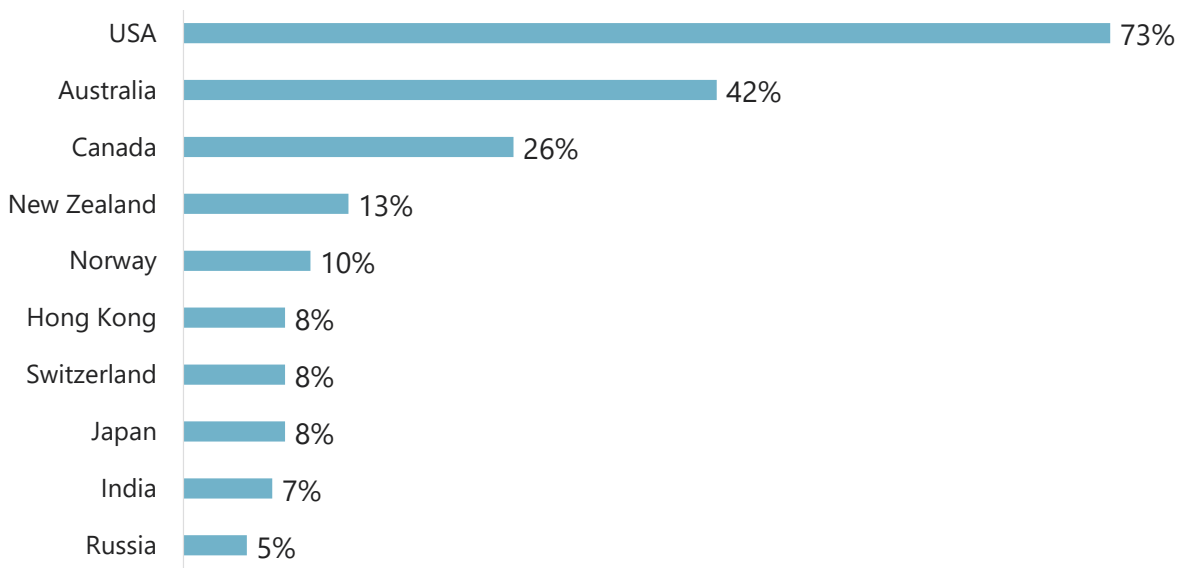
7 Trading in the Rest of the World

This chapter examines the trading patterns of businesses that made sales in non-EU countries, including the particular countries they traded in, whether goods and/or services were sold and the total value of digital sales to consumers located in non-EU countries. The research also estimates purchasing costs in non-EU countries. Please note that there are few subgroup differences due to the small base sizes; where significant differences exist they have been reported.

7.1 Trading locations

Outside of the EU, VAT unregistered businesses most frequently mentioned selling goods or services to Anglophone countries. Three quarters of businesses (73%) traded with the United States in the last financial year, 42% with Australia, 26% with Canada and 13% with New Zealand.

Figure 7.1: Countries outside of the EU sold goods and services to in the last financial year



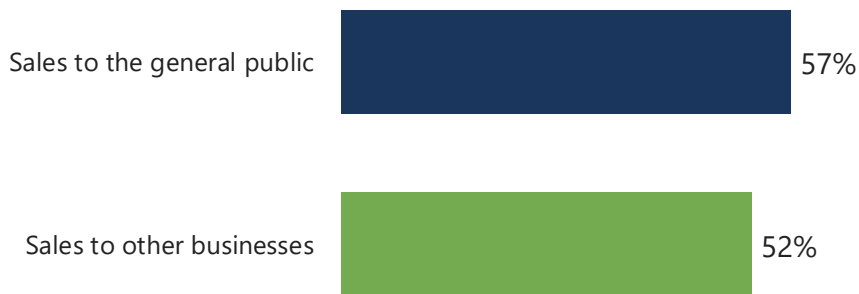
Base: All unregistered businesses who have sold goods or services in the RoW for at least one year (133)

Businesses that had been trading between 5 and 10 years (58%) were less likely to have sold goods or services to the United States. B2C businesses (55%) were more likely to have made sales in Australia.

7.2 Sales in the rest of the world

7.2.1 Business and consumer trade

Around half (52%) of businesses made sales to other businesses in the last financial year, and a slightly higher proportion (57%) sold to the general public. As was found with businesses that traded within the EU, the proportion of businesses that made sales to the general public in non-EU countries was significantly lower than overall (57% compared with 69%).

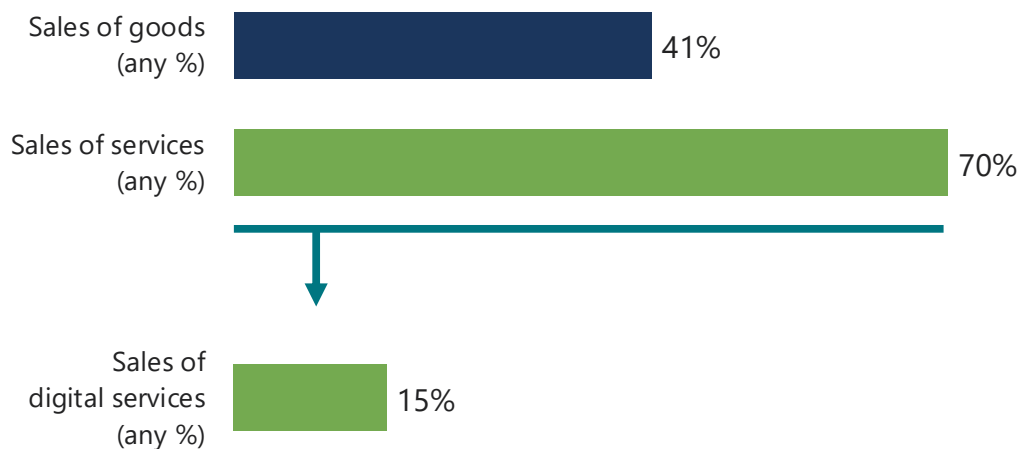
Figure 7.2: Type of sales made in countries outside the EU in the last financial year

Base: All unregistered businesses traded in rest of the world in last financial year (133) ; 'Don't know' 1%.

Among businesses that traded in the rest of the world, half (48%) made sales *only* to the general public in these countries, two in five (42%) made sales *only* to other businesses in non-EU countries and one in ten (10%) reported making sales to *both* businesses and the general public.

7.2.2 Sales of goods and services

Seven in ten (70%) reported selling services in non-EU countries in the last financial year; four in ten (41%) sold goods.

Figure 7.3: Sales of goods, services and digital services in countries outside the EU in the last financial year

Base: All unregistered businesses who sell goods and services, and trade in the rest of the world (133); *All unregistered business which sell services in the rest of the world (40)

Businesses that made sales mainly to other businesses were significantly more likely to have sold services (89%) and significantly less likely to have sold goods (16%) in non-EU countries. In contrast, those that sold mainly to the public were significantly more likely to have sold goods (61%) and less likely to have sold services (56%).

Those with an agent were also more likely to have sold services to non-EU countries (80%).

7.2.3 Sales of digital services in the rest of the world

Among businesses that sold services in the last financial year to countries outside of the EU, 16% reported that at least some of their sales were digital services to the general public. This represented around four per cent of all businesses that sold goods or services in non-EU countries.

7.3 Costs of purchasing goods or services from the rest of the world

Among all VAT unregistered businesses, the majority (91%) reported that they had not purchased any overhead items from non-EU countries used in the production of goods or services for their business in the last financial year. Six per cent reported costs between £1 and up to £5,000 and only one per cent reported costs of more than £5,000.

Table 7.1: Purchasing costs outside of the EU in the last financial year

	Total
<i>Base</i>	<i>(2,004)</i>
£0 (zero)	91%
£1-£5,000	6%
£5,001+	1%
Don't know	2%

Businesses with a lower turnover (£8,000 to £30,000) were more likely to have no costs from countries outside the EU (93%), as were those that traded in the UK only (94%) and businesses that had been trading for over 20 years (95%). Businesses in the Accommodation and Food services (100%), Other Service activities (97%), and Construction (96%) sectors were also more likely to report having no costs from the rest of the world.

Businesses that incurred costs from non-EU countries were more likely to have a higher turnover of between £40,000 and £83,000 (12%) or have made sales to other countries (EU, 32%; rest of the world, 44%). The Information and Communications (21%), Wholesale and Retail (19%) and Art and Entertainment (16%) sectors also had higher proportions of businesses with costs from non-EU countries.

8 Accounts and record keeping

This section explores the use of accounting systems and agents for tax administration. It also looks at how businesses record sales, including whether they currently split B2B and B2C sales and UK, EU and non-EU sales in their records. Earlier we have seen the use of accountants and electronic records and software packages is more prevalent among businesses with a higher turnover and those which traded internationally. These businesses were also more likely to provide an exact figure for their turnover and purchasing costs in the last financial year, possibly related to having these more formalised systems.

8.1 Use of an agent

Seven in ten VAT unregistered businesses (72%) used an accountant or tax advisor for any of their tax affairs¹⁶.

The use of an agent was higher among:

- Companies (86% compared with 70% Sole Traders/ Partnerships).
- Employers (86% compared with 70% nano businesses).
- Businesses that mainly sold to the general public or had mixed transactions (76% and 82% compared with 63% B2B).
- The Transport and Storage, Accommodation and Food Service, and Construction sectors (86%, 85% and 82% compared with 72% overall).
- Businesses that only sold to customers in the UK in the last financial year (73% compared with businesses that sold in the rest of the EU (61%) or non-EU countries (62%)).
- Businesses that accounted for sales and purchases with paper records (77% compared with 65% software package and 64% manual electronic).
- Businesses in Scotland (83%); it was lowest among businesses in the South East (66%).

Businesses with a higher turnover were also more likely to use an agent (84% with a turnover £60,000 to £83,000 compared with 65% with a turnover £8,000 to £20,000). The same pattern emerged among businesses with higher costs (75% with purchases of more than £5,000 used an agent compared with 68% with costs up to £5,000). Among those with zero costs, seven in ten (71%) used an agent, in line with the overall findings.

8.2 Method of record keeping

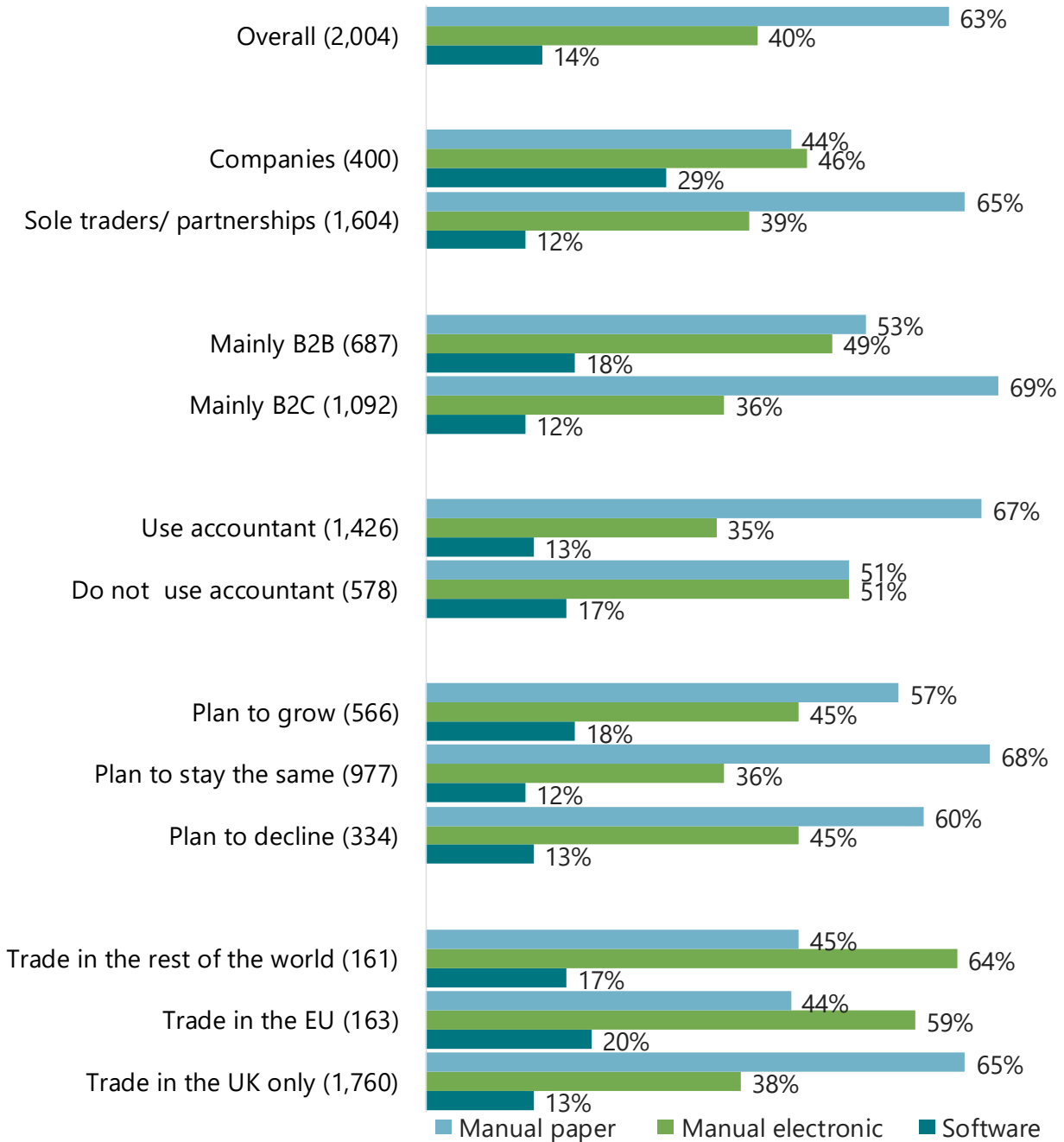
Respondents were asked if they accounted for sales and purchases with manual paper or electronic records (e.g. Excel spreadsheets), or a computerised software package such as SAGE or free HMRC software. The most common method for

¹⁶ The question did not specify whether accountants or tax advisors were paid so could include paid and unpaid agents

record keeping among VAT unregistered businesses was manual paper books and records (63%). Two in five (40%) used manual electronic records and only 14% used a computerised software package¹⁷.

The method of record keeping varied considerably by trading status, agent usage, whether the business mainly made sales to the general public or other businesses, traded in the UK or internationally, and future growth prospects, as shown in Figure 8.1.

Figure 8.1: Method of record keeping between different groups



Results sum to more than 100% as respondents could select more than one response at this question

¹⁷ Results sum to more than 100% as respondents could select more than one response at this question.

Sectoral variations were also apparent. Businesses in Financial and Insurance Activities and Professional, Scientific and Technical Services were significantly more likely to use software for their record keeping (39% and 24% respectively). Conversely, sectors which were significantly more likely to use manual electronic records included Administration and Support Service Activities (58%), Arts, Entertainment and Recreation (56%), Wholesale and Retail (52%), Professional, Scientific, Technical services (51%) and Human Health (51%). Paper records were more likely to be used by the Agriculture (80%), Construction (75%), Transport and Storage (77%) and Other Service Activities (71%) sectors.

8.3 Organisation of records

VAT unregistered businesses that sold goods and services to other businesses *and* the general public were asked if they had separate accounts or record keeping for sales to businesses and sales to the general public¹⁸. Only 13% said they separate their accounts in this way.

VAT unregistered businesses that sold goods and services to customers in the UK *and* other countries were also asked if they separated accounts for sales within the UK, other EU countries and the rest of the world. Again only a minority (10%) reported separating out sales by different areas. This was consistent among all types of businesses that participated in the research.

¹⁸ Businesses were told separating accounts also includes using the same account but having different columns to separate out sales to other businesses and the general public.

9 Business performance

This section examines the financial performance of VAT unregistered businesses, including how turnover had changed over the last two financial years and whether this had been driven by the UK, other EU or non-EU countries. It also explores prospects for future growth and how those that expected to grow planned to do this – including whether they expected to move into new markets in the UK or other countries. It also explores the hypothetical situation of VAT unregistered businesses' response to becoming VAT registered.

9.1 Financial performance

More than two in five businesses (43%) reported that their turnover had remained stable over the last two financial years (between 2014/15 and 2015/16); three in ten (31%) reported growth and a quarter (24%) said their turnover had declined.

Table 9.1: Financial performance

	Overall	Traded internationally
<i>Base</i>	<i>(2,004)</i>	<i>(186)</i>
Grown between 14/15 - 15/16	31%	41%
Grown by 20% or more	8%	17%
Grown by less than 20%	22%	23%
Stay around the same	43%	36%
Declined between 14/15 - 15/16	24%	23%
Declined by 20% or more	13%	15%
Declined by less than 20%	10%	7%
Don't know	4%	2%

Businesses in the Accommodation and Food Services, Financial and Insurance, and Arts, Entertainment and Recreation sectors were more likely to have grown (49%, 47% and 45% respectively). In contrast, a higher proportion of businesses in the Transport and Storage (36%) and Wholesale & Retail (35%) sectors had declined. Businesses in the Construction sector were more likely to have remained stable (51%).

While 24% of businesses overall said their turnover had declined over the last two financial years; a third of businesses in the North East (33%) and London (32%) reported this. Businesses in the South West and West Midlands (both 14%) were more likely than average (eight per cent) to have grown by more than twenty per cent in this time. Those businesses that traded internationally were also more likely to have experienced high growth, although a similar proportion to overall had declined (as shown in Table 9.1).

Aside from sectoral and regional differences, businesses trading for up to 20 years were more likely to have grown over the last two financial years (35% compared with 20% of older businesses). Those making sales mainly to other businesses were also more likely to have grown (36% compared with 30% B2C). Businesses with high input costs were more likely to have declined (36% compared with 24% of businesses with low input costs and 23% with medium input costs).

Of the businesses that traded internationally and had grown, around two-thirds (65%) said that this was due to sales in the UK¹⁹; only four per cent said it was due to sales in the EU and one in six (16%) said it was due to sales in the rest of the world. A significant minority (15%) did not know where the growth came from. A similar pattern was evident among those businesses that have declined, with a greater proportion unsure of the source of the decline. A breakdown is shown in Table 9.2.

Table 9.2: Location of change in sales

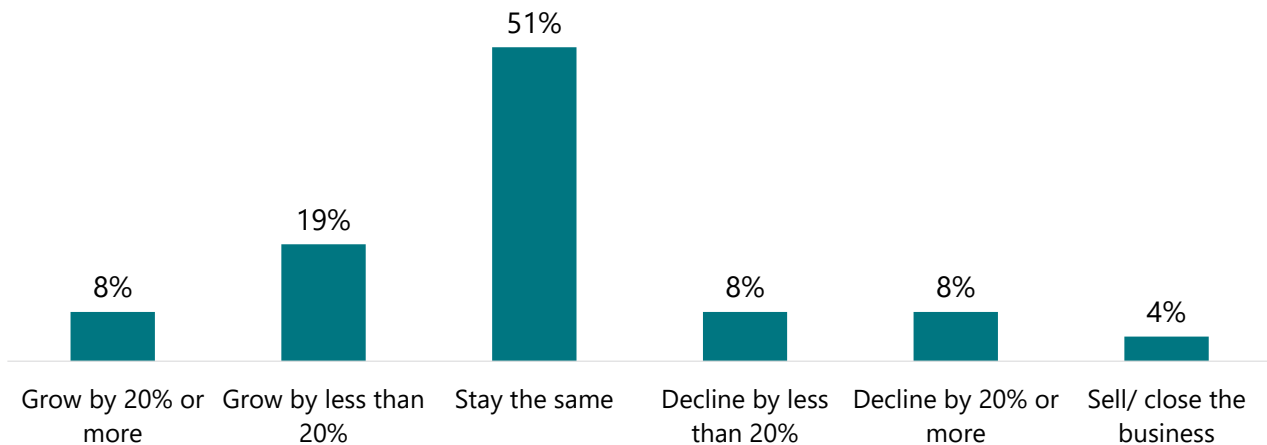
	Grown	Declined
Base	(79)*	(56)*
UK	65%	62%
EU	4%	4%
Rest of the World	16%	4%
Don't know	15%	29%

*denotes small base size of less than 100

9.2 Prospects for future growth

Looking towards the next 12 months, half of VAT unregistered businesses (51%) expected their turnover to stay around the same, a quarter (27%) thought it would grow and one in seven (15%) expected it to decline. A minority (four per cent) planned to sell or close their business.

Figure 9.1: Change in turnover in the next 12 months



Base: All unregistered businesses with turnover £8k-£83k (2,004)

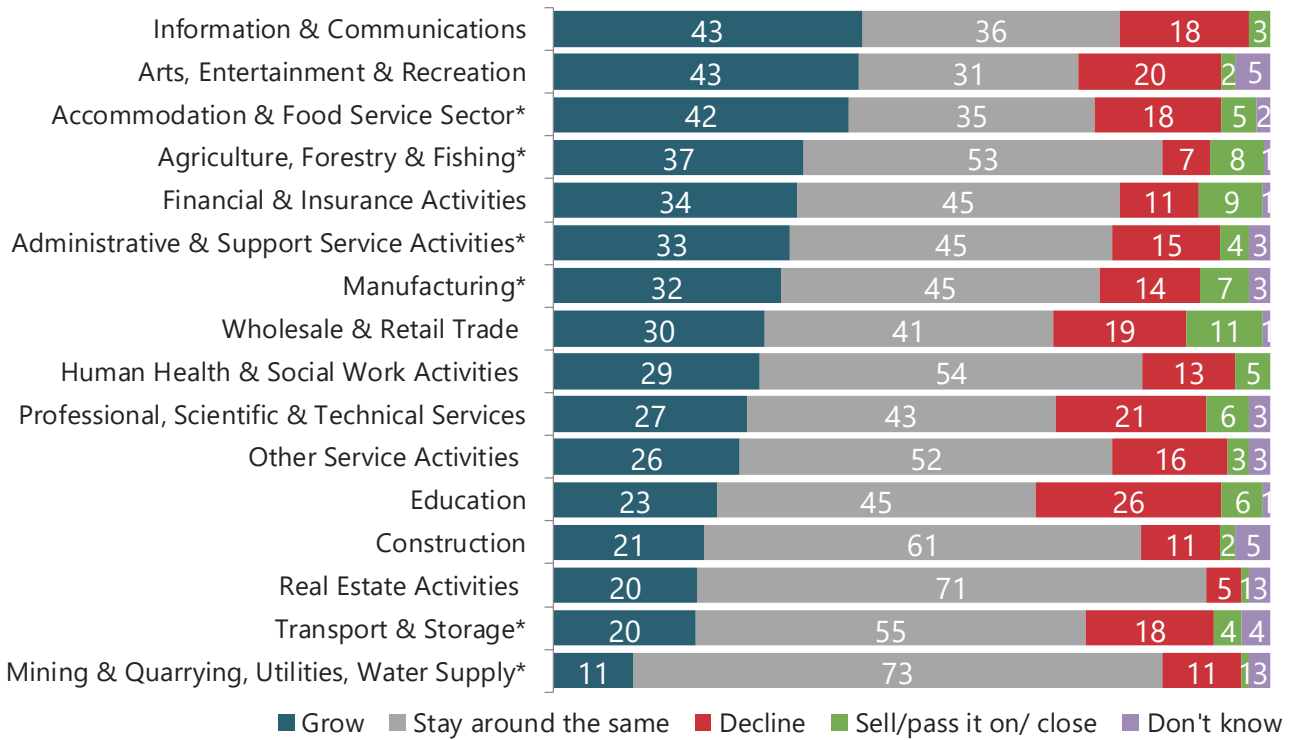
The sectors most likely to expect growth were those that had experienced growth over the last two financial years: Arts, Entertainment and Recreation (43%) and Accommodation and Food Service (42%). Businesses in the Education sector were most likely to expect a decline (26%), and a significantly higher proportion in the Wholesale and Retail sector expect to close or sell their business (11%). Figure 9.2 gives a full sector breakdown.

As with past performance, younger businesses were more likely to expect to grow in the next 12 months (41% of those trading up to five years compared with 30% trading 6 to 10 years and 22% trading more than 10 years). Three in ten (30%)

¹⁹ The largest proportion of their turnover was generated through sales in the UK as outlined in section 5.2.

businesses that declined in the last two financial years expected their business to contract further in the next 12 months (compared with 12% of businesses that grew and 10% of those that stayed around the same over the same period). The only regional variation was in the South East where businesses were more likely than average to expect to decline in the next 12 months (20% compared with 15% overall).

Figure 9.2: Change in turnover in the next 12 months by sector



* denotes a small base size of less than 100

Base: Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

Businesses that traded internationally were more optimistic about future growth. A higher proportion of those that traded in the EU (45%) or the rest of the world (43%) expected to grow compared with those that traded exclusively in the UK (26%). Conversely, around half (52%) of businesses that traded only in the UK expected to stay the same size over the next 12 months compared with 30% that traded in the EU and 36% that traded in the rest of the world.

Figure 9.3 shows among VAT unregistered businesses that expected to grow in the next 12 months most planned to do so by increasing their marketing (39%), increasing sales by moving into new markets (33%) or by raising their prices (31%).

Figure 9.3: Business plans for achieving growth

Base: All unregistered businesses who plan to grow (566)

Newer businesses were more likely to say they planned to grow by increasing marketing (48% trading for less than 5 years compared with 33% trading for more than 10 years). Businesses trading for more than 5 up to 10 years were more likely to introduce new products or services as a means of achieving growth (27% compared with 11% trading 20+ years).

Businesses that made sales to non-EU countries were significantly more likely to introduce new products or services (36% compared with 22% that only made sales to customers in the UK).

Cutting back on expenses was popular among businesses that mainly deal with the general public (20% compared with nine per cent of businesses that mainly traded with other businesses). Businesses with higher purchasing costs were also more likely to aim to reduce expenses (21% with costs of more than £5,000 compared with nine per cent with costs up to £5,000). This was also evident among businesses in Wales and London (32% and 29% respectively planned to cut back on expenses compared with 16% across the UK).

Among businesses that expected to increase sales by moving into new markets, around one in five (18%) planned to move into markets in other countries. However, most (74%) planned to move into new markets in the UK only and only a minority planned to move into markets in the EU only (one per cent) or only other countries in the rest of the world (four per cent).

Table 9.3: Location of new markets

Increasing sales by moving into new markets	Total
<i>Base</i>	<i>(167)</i>
UK	85%
UK only	74%
EU	14%
EU only	1%
Rest of the World	16%
Rest of the World only	4%

9.3 Expected response to becoming VAT registered

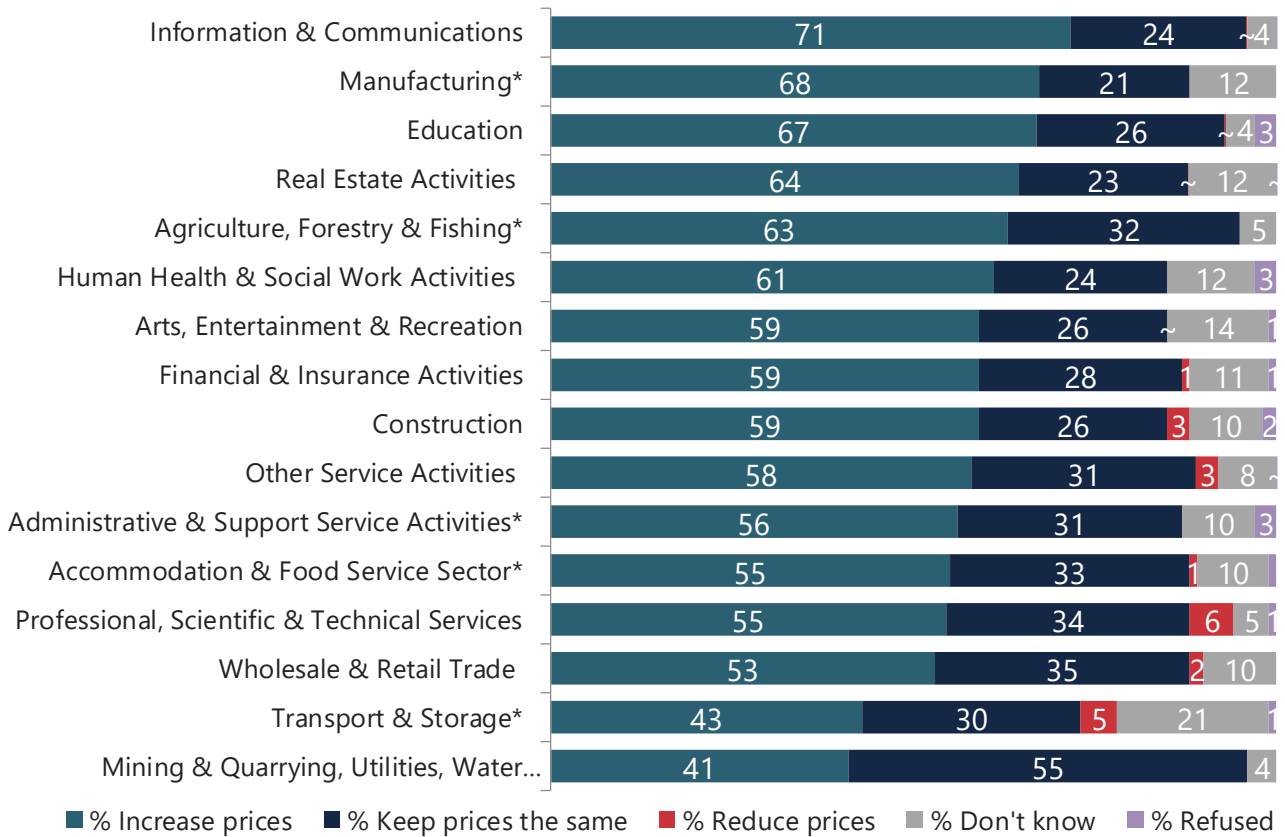
A hypothetical question was posed to businesses to understand how they would react to being VAT registered²⁰. Businesses were asked to consider whether they would make any changes to their prices as a result of charging VAT on the goods and services they sold, bearing in mind the VAT they could reclaim and their market competition. Six in ten businesses (58%) said they would increase prices to cover all or some of the amount of VAT charged; three in ten (29%) would keep prices the same. Two per cent would reduce their prices. Overall, one in ten (10%) did not know what they would do if they were VAT registered and one per cent refused to answer.

- Businesses trading for more than 20 years were more likely to say they would increase their prices to cover some or all of the VAT charged (64% compared with 55% trading up to 5 years).
- Businesses with higher input costs were more likely to say they would keep prices the same (41% compared with 26% of businesses with medium input costs).
- Businesses with mixed transactions were more likely than those that only sold to the general public to expect to increase prices (69% compared with 56%). There were no significant differences among B2B businesses.

The expected response to registering for VAT was also consistent by turnover, sector and region.

²⁰ Caution should be taken when interpreting these findings as they are based on respondents' perceptions of any changes they might make to their prices if they became VAT registered rather than actual behaviour.

Figure 9.4: Expected VAT behaviour by sector



* denotes a small base size of less than 100

Base: Mining and Quarrying; Electricity, Gas, Steam and Air Conditioning Supply; Water Supply, Sewerage and Waste Management: 67; Agriculture, Forestry and Fishing: 70; Manufacturing: 60; Construction: 262; Wholesale and Retail: 128; Transport and Storage: 88; Accommodation and Food Service: 97; Information and Communications: 107; Financial and Insurance activities (excluding holding companies): 131; Real Estate Activities: 141; Professional, Scientific and Technical Activities: 159; Administrative and Support Service Activities: 98; Education: 156; Human Health and Social Work Activities: 141; Arts, Entertainment and Recreation: 131; Other Services Activities: 166; Overall: 2,004.

10 Conclusion

VAT unregistered businesses comprised a heterogeneous population including sole traders and companies, businesses that mainly traded with other businesses and those that made most of their sales to the general public, businesses that traded internationally and those that were looking to grow.

Overall, VAT unregistered businesses were more likely to sell goods and services to the general public than other businesses, although the proportion of B2C sales varied widely by the 16 key sectors. Those sectors that traditionally serve the general public were more likely to have a higher proportion of B2C sales (for example, the Accommodation and Food Service, and Wholesale and Retail Trade sectors), compared with sectors that are more professionally focused or office based which did more trade with other businesses (for example, Professional, Scientific and Technical Activities and Information and Communications sectors).

The research also provided evidence on the proportion of small businesses that traded in other EU Member States and the rest of the world. Nearly all VAT unregistered businesses made sales to customers in the UK in the last financial year, but only a minority sold goods and services to other countries. Some sectors were more likely to trade internationally (for example the Wholesale and Retail sector), and businesses which expected to grow in the next 12 months were also more likely to trade in other countries. However, among all VAT unregistered businesses that traded internationally, the largest proportion of their turnover was still generated through sales in the UK.

Among businesses that made sales to other countries (whether in the EU or elsewhere), compared with all businesses, the proportion selling to the general public was significantly lower (although still over half). Businesses were also more likely to have sold services than goods in these areas, although very few sold digital services to the public. Therefore, the majority of businesses were unlikely to be affected by the VAT treatment of B2C sales of digital services.

More businesses reported that their turnover had remained stable over the last two financial years (than grown or declined). Businesses that traded internationally were more likely to report growth, although this was mostly due to an increase in sales in the UK. Looking ahead, while half of businesses expected to stay the same over the next 12 months, among the rest more expected to grow than decline. Furthermore, VAT unregistered businesses that traded internationally were more optimistic about future growth.

Appendix 1 Sample outcomes

A stratified random sample of 23,270 leads was drawn by HMRC from Self-assessment and Corporation Tax records collected in 2013/14. The sample was selected randomly to populate strata provided by Ipsos MORI. Businesses in certain sectors and companies were purposively over-represented to make up for their relatively low incidence within the representative population as specific sector information was also of interest.

Around 13,496 of the records received from HMRC had phone numbers (58%), so tele-matching, using publicly available data provided by UK Changes, was conducted on the whole sample. This provided an additional 4,056 leads with phone numbers. After selection, 13,951 businesses were sent an advance letter before fieldwork began, asking if they wished to opt out of the study. The number of opt-outs received was 1,090 (8%).

Table A.1 – Breakdown of sample used and response rate

	All sample		Valid sample ²¹	
	N	%	N	%
Complete interviews	2,004	16	2,004	40
Refusals (including abandoned interviews)	2,338	18	1,122	22
Screened out	2,153	17		
Unresolved ²²	3,748	29	1,799	36
Not available in fieldwork period	177	1	85	2
Bad numbers	2,441	19		
Total sample	12,861	100	5,010	100
Ineligible (screen out/complete + screen-out))		52%		
Co-operation rate²³ (complete/(complete + refusal))		46%		
Unadjusted response rate (complete/all sample)		16%		
Adjusted response rate (complete/valid sample)				40%

²¹ Taking into account ineligibility rate of 48%.

²² These are cases which at the end of fieldwork the sample lead was not converted to a completed interview and was not confirmed as an unusable lead or refusal either. The vast majority of these were called by Ipsos MORI on more than 10 occasions and many were contacted at least 20 times.

²³ The co-operation rate is the proportion of all respondents who agreed to complete an interview, excluding those who refused and abandoned the interview.

Appendix 2 Sample profile

Table A2: Breakdown of interviews by sector

Sector	No. of completed interviews (unweighted)	No. of completed interviews (weighted)	Percentage of overall sample (weighted)	Percentage of overall sample (weighted)
Construction	262	504	13%	25%
Other Service Activities	167	261	8%	13%
Professional, Scientific and Technical Activities	159	165	8%	8%
Administrative and Support Service Activities*	98	152	5%	8%
Human Health and Social Work Activities	141	140	7%	7%
Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles	129	131	6%	7%
Arts, Entertainment and Recreation	131	126	7%	6%
Transportation and Storage*	88	117	4%	6%
Education	156	99	8%	5%
Financial and Insurance Activities	131	53	7%	3%
Accommodation and Food Service Activities*	97	52	5%	3%
Agriculture, Forestry and Fishing*	70	51	3%	3%
Real Estate Activities	141	46	7%	2%
Information and Communications	107	42	5%	2%
Manufacturing*	60	43	3%	2%
Mining and Quarrying; Utilities, Water Supply *	67	22	3%	1%
Grand Total	2004	2004	100%	100%

*denotes small base size of less than 100

Appendix 3 Weighting approach

Weights were required to correct for biases caused by differences in selection probabilities. However, no attempt was made to adjust the sample for biases caused by differential response rates. This is because the sector information on the sampling frame was incomplete, meaning we did not have a robust set of population totals for our population of interest that we could weight to.

Selection weights

The sample of businesses was sampled with unequal selection probabilities, meaning businesses in smaller sectors had a higher chance of being selected for the sample. This was to ensure there was a sufficient number of businesses per sector in the final sample (the aim was to get a minimum of 100 interviews per sector). In addition, there were differences in the selection probabilities of companies and sole-proprietors/partnerships. Companies were given a higher chance of selection compared with sole-proprietors/partnerships to ensure a good representation of companies in the final sample, to enable them to be analysed separately.

The selection weights adjust the sample to correct for these biases. Selection weights make the issued sample representative of the population from which it was selected, thereby removing any biases that were introduced as part of the sample design.

Non-response adjustments

We did not attempt to make a further adjustment for non-response to the survey as there were some concerns about the quality of sector information on the sampling frame (sector information was missing completely for 55% of companies and 22% of sole proprietors/partnerships).

Final weights

The final weights vary within sector, partially due to the sample design (the selection probabilities within a sector varied for companies and sole proprietors/partnerships), but also due to sector 'swappers'.

Businesses 'swap' sectors when the information recorded on the sampling frame is different to that recorded in the interview. The selection weights were generated using the sector information recorded on the sampling frame, as this information was used during sampling. Selection probabilities varied by sector, with businesses in smaller sectors having a higher chance of being selected.

Sector information was collected during the interview and businesses were reallocated to sectors based on this. Around one quarter (26%) of the businesses that had some sector information from the sampling frame were allocated to a new sector based on the information collected at interview. Businesses that were selected from the 'unknown' sector codes sampling stratum were also allocated to sectors based on information from the interview. These businesses carry their original weights with them, which may be different to the weight they would have had if they had been selected via the correct sector. This increases the variability of weights within a sector. However, it also takes into account that these cases had different chances of being selected to start with; if there is something special about the swappers and businesses with unknown sector codes, then it is important to ensure they are correctly represented in the sample.

Appendix 4 Margins of error

Weights were required to correct for biases caused by differences in selection probabilities. However, no attempt was made to adjust the sample for biases caused by differential response rates. This is because the sector information on the sampling frame was incomplete, meaning we did not have a robust set of population totals for our population of interest that we could weight to.

The table below shows the effective sample size, the unweighted sample size and 95% confidence intervals for sector-level estimates.

Table A3: Confidence intervals for each sector

Sector	Effective base	Actual base	95% confidence interval for a survey estimate of...		
			10%	30%	50%
Mining & Quarrying, Electricity, Gas, Steam and Air Conditioning, Water Supply, Sewerage and Waste Management	10	67	18.6	28.4	31.0
Agriculture, Forestry & Fishing	45	70	8.8	13.4	14.6
Manufacturing	38	60	9.5	14.6	15.9
Construction	228	262	3.9	5.9	6.5
Wholesale & Retail	91	129	6.2	9.4	10.3
Transport & Storage	75	88	6.8	10.4	11.3
Accommodation & Food Service Sector	48	97	8.5	13.0	14.1
Information and Communications	35	107	9.9	15.2	16.6
Financial and Insurance Activities	64	131	7.4	11.2	12.3
Real Estate Activities	37	141	9.7	14.8	16.1
Professional, Scientific and technical activities	118	159	5.4	8.3	9.0
Administrative and Support Service Activities	78	98	6.7	10.2	11.1
Education	88	156	6.3	9.6	10.4
Human Health and Social Work Activities	97	141	6.0	9.1	10.0
Arts, Entertainment and Recreation	97	131	6.0	9.1	10.0
Other Service Activities	146	167	3.8	5.7	6.3
All sectors	1650	2004	1.4	2.2	2.4

Confidence intervals are a measure of precision. A 95% confidence interval is constructed so that 95 times out of 100 it will contain the true population figure. A narrower interval indicates a higher level of precision. Based on this design, the confidence interval for a survey estimate of 10% from Wholesale and Retail is expected to be around +/-6.2%, meaning the true population value is likely to fall between 3.8 and 16.2%.

The effective sample size shows the size a Simple Random Sample (SRS) would need to be to yield survey estimates of the same level of precision as the design under consideration. A SRS can be thought of as the 'gold standard' in sampling, hence a design where the effective sample size is close to the actual sample size will give good levels of precision. Reducing the variability in sampling fractions would increase the sampling efficiency and result in a larger effective sample size. However, it must be remembered that sample design is a trade-off between improving sampling efficiency and having sufficient numbers for sub-group analysis. The unequal sampling fractions in this design were purposive; we oversampled smaller sectors relative to larger sectors and companies relative to sole traders/partnerships. This was done to allow sufficient numbers per group for sub-group analysis. There was also some unavoidable movement of business across sectors, as discussed in the weighting section.

The confidence intervals in the table above are based on the effective sample size, not the actual sample size, hence they are a truer representation of the levels of precision we would expect from the design (basing them on the actual sample size would be a crude approximation). For the majority of estimates in most sectors confidence intervals fall between 6-15%. Precision is higher for overall estimates. The estimates from Mining & Quarrying, Electricity, gas, steam and air conditioning, Water Supply, Sewerage and Waste Management should be treated with caution due to the small overall and effective base sizes.

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