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Qualitative research to understand digital tech businesses

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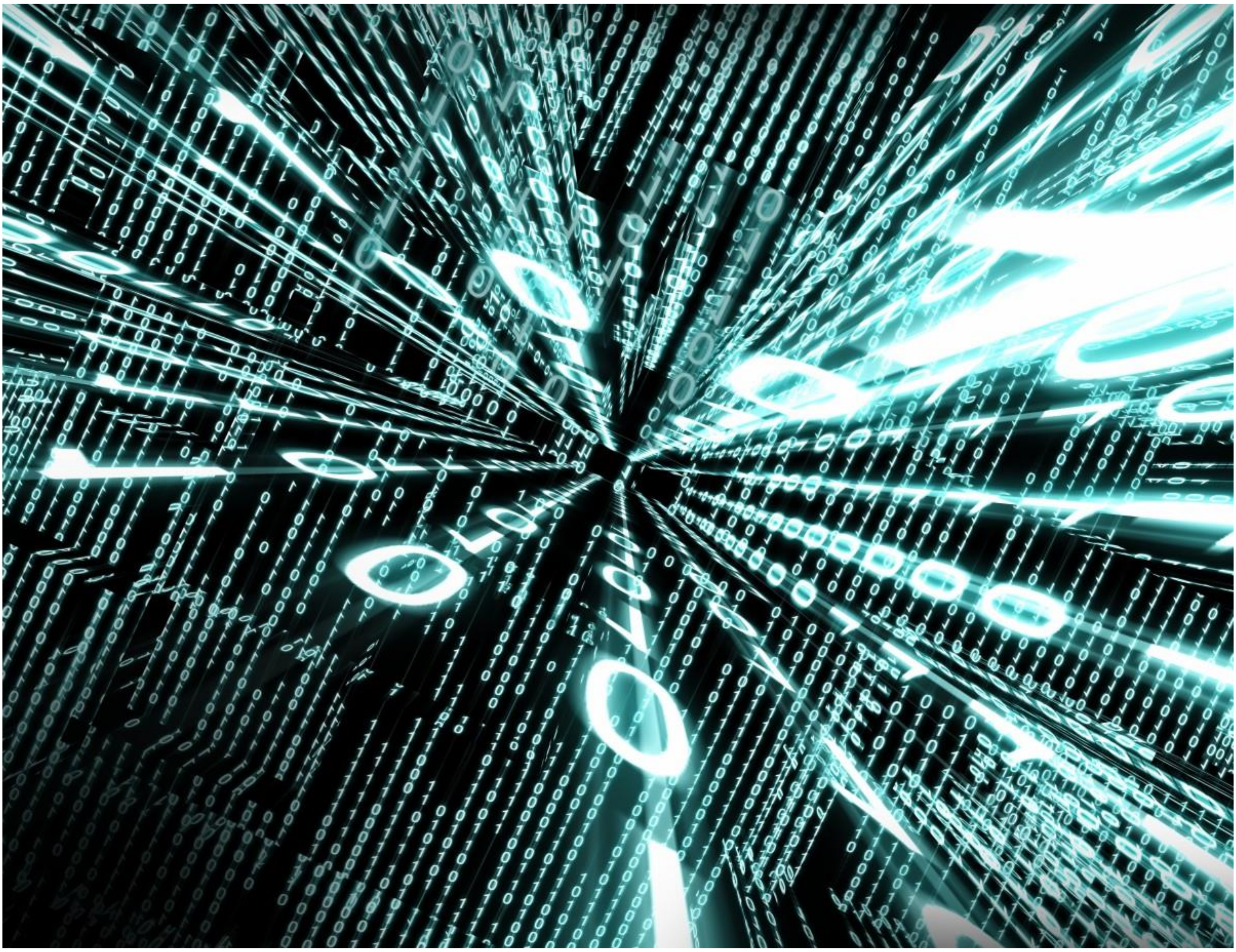

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Glossary

Term	Definition
Angel investor	An angel investor (or 'business angel') is a high net worth individual who provides capital for a business – typically in exchange for convertible debt or ownership equity.
Bitcoin	A form of digital currency (or 'cryptocurrency') which is created and held electronically. They are produced by people and businesses, globally, using software.
Digital tech business	Businesses that provide a digital, technical service or product (including hardware and platforms) as their primary revenue source, or provide a product or service that is reliant on digital technology as its primary revenue source[1].
Edtech	The abbreviated form of 'educational technology' – the design, creation and application of technology for learning.
Enterprise Investment Scheme (EIS)	A Government scheme designed to help smaller companies raise finance by offering tax reliefs to investors who purchase new shares. They can invest up to £1million in a tax year, receive 30% tax relief, and are locked into the scheme for 3 years[2].
Fintech	The abbreviated form of 'financial technology'. Fintech covers the application of technology across all elements of finance (e.g. Bitcoin, global money transfers, accounting software, crowdfunding).
Research and Development (R&D) Tax Relief	A company can claim R&D Tax Relief if an R&D project seeks to achieve an advance in overall knowledge or capability in a field of science or technology, through the resolution of scientific or technological uncertainty. The R&D Tax Relief scheme for small or medium enterprises (SME) reduces their tax bill where they are liable for Corporation Tax (CT)[3].
Seed Enterprise Investment Scheme (SEIS)	A government scheme designed to help small, early-stage companies raise equity finance by offering tax reliefs to investors purchasing new shares. Investors (including directors) can receive initial tax relief of 50% on investments up to £100,000 and Capital Gains Tax (CGT) exemption for any gains on the SEIS shares. The maximum amount to be raised for each company is £150,000[4].
Seed investment	Initial capital used when starting a business.
Tech capable	Founders who had the skills to develop the technology for their business.
Tech dependent	Founders who lacked the technical skills to develop the technology for their business.
Transitioning business	Businesses who started trading as non-digital businesses, but whose models have become increasingly digitally focused, e.g. they might have moved more sales online.
Venture Capital	A type of private equity provided by firms or funds to small, early-stage businesses thought to have high growth potential, or who have demonstrated high growth. Risk is typically high for investors, and venture capitalists usually partake in business decisions in return for investment.

[1] Tech City and Nesta (2016) Tech Nation 2016: Transforming UK Industries, available at: http://www.techcityuk.com/wp-content/uploads/2016/02/Tech-Nation-2016_FINAL-ONLINE-1.pdf

[2] See the GOV.UK website for more details on EIS: https://www.gov.uk/government/publications/the-enterprise-investment-scheme-introduction

[3] See the GOV.UK website for more details on R&D Tax Relief: https://www.gov.uk/guidance/corporation-tax-research-and-development-rd-relief

[4] See the GOV.UK website for more details on SEIS: https://www.gov.uk/guidance/seed-enterprise-investment-scheme-background

Summary

The research requirement and method

Estimates suggest that around 1.56 million jobs exist in the UK digital economy and that their combined turnover stands at £161 billion[5]. The Government is committed to supporting their growth and through this research, HMRC intends to better understand how these businesses think and operate in relation to their tax requirements, their growth ambitions and patterns of growth, and their overall attitudes towards tax compliance.

Between January-April 2016, Ipsos MORI undertook qualitative interviews with 50 UK digital tech businesses across a range of growth stages, sizes (sole trader, small or mid-sized)[6] and sectors (app and software development; digital advertising and marketing; digital media and entertainment; e-commerce; edtech; and fintech).

The characteristics of digital tech businesses and the challenges they face

Several digital tech businesses had experienced long development phases, often two to three years long, before their product or service was market-ready. As a result of these lengthy development phases – consisting of high expenditure and minimal income (outside of investment income) – it was common for these businesses to remain unprofitable for a number of years, and business owners often expected this to be an inherent part of launching a digital tech start-up.

The challenges digital tech businesses identified were similar to those faced by all start-ups, but issues around accessing finance and establishing a consistent customer base were more acute for those operating in the digital space, where investors and consumers were still catching up with technological innovations. This was particularly the case for those digital tech businesses operating in an entirely new market – one of two broad types of business that the research came across:

Ground-breakers: Those operating in an entirely new market, or addressing a problem that previously had not been (or could not be) solved	**Facilitators:** Those seeking to facilitate or replace existing products or services, with a simpler, cheaper or more convenient alternative
E.g. an e-commerce and marketplace business designing online avatars to assist with purchasing clothes online	E.g. fintech businesses specialising in online accountancy advice and the transitioning businesses

Accessing finance was a common challenge across different stages of growth, with some businesses struggling to raise initial seed investment; obtain the right amount of funding; or find an investor who was right for their business. Accessing seed investment was particularly challenging for those operating in an entirely new market, as there was little or no precedent for potential investors to base their decision on. Some businesses considered the UK investor market to be less open to risk than the US, with traditional banks in particular seen as averse to

[5] Tech City and Nesta (2016) Tech Nation 2016: Transforming UK Industries, available at: http://www.techcityuk.com/wp-content/uploads/2016/02/Tech-Nation-2016_FINAL-ONLINE-1.pdf

[6] HMRC's definitions used throughout for small (under £10million turnover **and** fewer than 20 employees) and mid-sized (over £10million turnover **and/or** more than 20 employees) businesses.

investing in high-risk endeavours - namely, the inherent lengthy development phases, high initial expenditure and low initial income, time taken to become profitable and the risk of the business failing altogether. As a result, there was a pattern of self-funding at the start-up phase across various businesses.

Establishing a consistent customer base that could support a viable business was also a common challenge for businesses of both types, above. While this is likely to be the case for non-digital start-ups as well, several factors contributed to this challenge:

- Slow sales cycles
- A common lack of sales and marketing expertise (both in terms of staff capacity and knowledge amongst founders and directors, who tended to be more technically-minded)
- The fact that some of the concepts or services on offer had to be demonstrated several times, often for free, before customers understood their value.

Attracting and keeping staff was particularly important for digital tech businesses, given that some had significant technical requirements, while others needed strong sales and business development staff to help develop their customer base. **Remuneration was therefore often structured around the need to retain staff**, rather than being formulated specifically in a tax-efficient manner. In several cases, more established businesses offered share options to compensate for lower-than-market salaries, reward loyalty, or to allocate a strategic role for key staff members. At the same time, there were various examples of salaries being paid below the perceived market rate at start-ups, so retaining staff in competition with larger businesses and their more attractive salaries was outlined as a challenge.

Enabling business growth

Schemes and incentives such as Research & Development Tax Relief, the Seed Enterprise Investment Scheme and Enterprise Investment Scheme were felt to enable businesses to manage the length of their development phases, attract investment and, ultimately, to grow. In particular, those operating in entirely new markets felt that without these reliefs, they would not have gained the investment they needed to develop their product or service. The array of tax reliefs available and the impact they had on businesses contributed to the UK being seen as a supportive environment, including by those with experience of setting up businesses in other countries.

Owners had varying reasons behind growing the business. Some were looking simply to become profitable, while others aimed to expand abroad, increase staff levels and expertise, or to sell the business on. These expansion aims often came above profitability as a priority – sometimes reflecting a wider aim among these businesses to establish themselves as a sustainable business or market leader, which they viewed as a precursor to profitability.

Support networks were important to digital tech businesses as they were used to discuss problems, solutions and experiences of growth, access to funding and other issues related to being in the digital industry**.** Local networks (i.e. other digital tech businesses located nearby), investors and accountants were common sources of support – the latter two particularly so for smaller businesses.

Managing tax requirements as businesses grow and sources of support

Recordkeeping was typically done in-house, rather than outsourced, with founders often taking direct responsibility for this in the early stages of the business. A widespread use of recordkeeping software reflected the value these businesses placed on flexibility – many businesses noted that software would sync with their online platforms and bank accounts, and could be used on a mobile phone for updating records when working away from the office.

Use of accountants for submission of tax returns was very widespread, and for those in the early start-up stages who prioritised developing their product, service or establishing a customer base, there was often a sense among them that they had deferred responsibility for tax to their accountants. In some instances, there were examples of tax errors made (e.g. PAYE underpayments) due to poor communication between founders and accountants. On the other hand, many founders felt it was important to maintain an overview of their business's tax requirements, as part of understanding their overall financial position.

Photo of a digital tech business's recordkeeping software

Businesses felt their systems for recordkeeping had often improved as they had grown –and as founders became more confident that they had a viable business. There were examples where internal admin support had been brought in to free up founders' time and to help deal with increased transactions or increasingly complex tax affairs as the business grew. Those who had improved their systems, as well as those who had previous business experience or were more established, were also more confident that the tax information they provided to HMRC was correct. Automating manual recordkeeping processes was also felt to significantly reduce the burden of recordkeeping. For example, replacing the need for a member of staff to enter figures from one source to another was mentioned in several instances.

Some tax obligations, such as VAT and PAYE, were felt to be designed with larger businesses in mind. For example, two businesses felt that different VAT rates on e-Books unfairly affected competition, and navigating the VAT MOSS system[7] was seen as particularly complex by some smaller digital tech firms with EU customers. Corporation Tax was less of an issue for the businesses interviewed, reflecting that many were not making a profit so had not paid this tax.

Businesses had little *proactive* interaction with HMRC, reflecting that their accountants were more often their first port of call for tax advice and guidance. Those who had dealt with HMRC, felt that support would be more helpful if the Department had a better understanding of digital tech businesses and the context in which mistakes were made, and if businesses themselves were better equipped to understand their tax requirements. There was appetite for moving more of HMRC's processes online, or to automate, but awareness of HMRC's digital focus was generally low. There was also a call for joined-up working between HMRC and other public bodies that businesses felt already had expert knowledge about digital tech sectors – examples raised included UK Trade and Investment and Innovate UK.

Attitudes towards tax compliance

Businesses' attitudes towards compliance were often linked to their growth stage, and their ability to manage tax requirements alongside the day-to-day running of their business. Three prevailing attitudes emerged:

[7] VAT Mini One Stop Shop (VAT MOSS): This refers to EU rules regarding cross-border supplies of digital services from businesses to consumers. Effective from January 2015, the place of taxation for these digital services is the location of the consumer, not the location of the business supplying the service. See GOV.UK for more information: https://www.gov.uk/guidance/register-and-use-the-vat-mini-one-stop-shop

Compliance is important, but the **associated complexity** means greater scope for error

Compliance has the **potential to take time away** from the key concerns of the business

Compliance and **assessing business performance** cannot be done without each other (particularly the case amongst more established or experienced businesses)

Businesses had various reasons for thinking that paying tax was important. Several raised the fact that tax was needed to fund shared services like the NHS, the army and education, and they also understood the direct implications for them in terms of the tax reliefs and rebates they received from HMRC. Furthermore, paying tax was considered important to avoid fines, legal issues, and to protect their business's reputation.

Participants did not consider tax avoidance and evasion to be a specific problem for digital tech businesses. They were unaware of instances of other businesses avoiding tax, as they typically did not discuss tax within their networks. With that said, some of the mid-sized businesses interviewed said they were more knowledgeable of and open to considering tax avoidance schemes, often in cases where they had brought in Finance Directors or Chief Financial Officers specifically to advise on tax and streamlining the business. However, tax avoidance was also condemned in several interviews, with certain businesses raising their own views that global tech corporations operating in the UK had created an image of tax avoidance that did not apply to these businesses as a whole.

1 Introduction

This report covers findings from qualitative research with UK digital tech businesses that took place in spring 2017. The findings explore their attitudes and behaviours towards tax requirements, and how well they think the UK tax system supports their business to grow. The research was undertaken by Ipsos MORI on behalf of HM Revenue and Customs (HMRC).

1.1 Background and objectives

Digital tech businesses provide a digital, technical service or product (including hardware and platforms) as their primary revenue source, or they provide a product or service that is *reliant* on digital technology as their primary revenue source [8]. These businesses are an increasingly significant part of the UK economy: the 2014 Annual Business Survey estimated their combined turnover at £161 billion and the 2014 Annual Population Survey suggests that around 1.56 million jobs exist in the UK digital economy. Digital tech businesses are transforming the UK economy and, as such, the Government is committed to supporting their growth[9].

Anecdotal evidence suggested that many digital tech businesses appear to differ significantly from the more traditional business models that HMRC is used to dealing with, including: a high proportion of start-ups; unorthodox ownership, employment and remuneration arrangements; very rapid growth, failure and restructuring cycles; and different types of 'agents' advising the businesses.

The overall aim of the research was to gather insight on the attitudes and behaviours of individual businesses towards tax requirements – and how they think and operate in relation to paying tax, claiming allowances and managing compliance with regulatory requirements. This will allow HMRC to design effective strategies and approaches to promote voluntary compliance and growth, as well as enabling them to provide tailored support as businesses transition from micro to small and then to mid-sized businesses.

Specifically, the core objectives of the research were to explore:

- The different business models and operating structures, to facilitate comparison with traditional models
- The systems and processes in place relating to tax requirements, including in relation to remuneration packages
- The attitudes of digital tech businesses towards tax requirements
- The sources of support they turn to
- Their growth ambitions and patterns of growth.

1.2 Summary of methodology

The research was required to explore, in depth, the approaches that digital tech businesses take to manage their tax requirements and *how* these relate to their stage of growth – as well as any barriers these businesses face. As such, a qualitative methodology was deemed most appropriate.

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[8] Tech City and Nesta (2016) Tech Nation 2016: Transforming UK Industries, available at: http://www.techcityuk.com/wp-content/uploads/2016/02/Tech-Nation-2016_FINAL-ONLINE-1.pdf

[9] See the Innovate UK Delivery Plan: Financial year 2015/16 for more information: https://www.gov.uk/government/publications/innovate-uk-delivery-plan-2015-to-2016

A total of 50 in-depth interviews were carried out with UK digital tech businesses, including face-to-face, telephone and Skype interviews, between January and April 2017. This included:

- Businesses from six digital economy sectors: app, software and games development; digital advertising and marketing; digital media and entertainment; e-commerce and marketplace; edtech; and fintech
- Two sole traders, 30 small businesses and 18 mid-sized businesses[10]
- 44 'born digital' businesses and six who were 'transitioning'. Transitioning businesses are more traditional, but are becoming increasingly digitally focused (such as moving more sales online), whereas 'born digital' businesses are involved in purely digital activities.

Sample was primarily sourced through Beauhurst, a commercial database researching UK high-growth companies. Sample was also manually sourced via online databases, LinkedIn, recruiter networks and references from existing participants. Comprehensive technical details of the methodology, including a list of sample sources, achieved interviews quotas and the approach to recruitment and fieldwork, are included in Appendix A. The topic guide for interviews is included in Appendix B.

1.3 Interpretation and representation of qualitative data

Qualitative approaches are used to explore the nuances and diversity of views, the factors which shape or underlie them, and the ideas and situations in which views can change. The results are intended to be illustrative, not statistically representative.

This report aims to provide detailed and exploratory findings that uncover the perceptions, behaviours and attitudes of digital tech businesses towards their tax requirements and growth prospects. The value of exploratory qualitative work is to identify the issues which bear future investigation.

Use of quotes

Verbatim comments have been included in this report to illustrate and highlight key points and common themes. Where verbatim quotes are used, they have been anonymised and attributed by sector and size.

[10] HMRC's definitions used throughout for small (under £10million turnover **and** fewer than 20 employees) and mid-sized (over £10million turnover **and/or** more than 20 employees) businesses.

2 Characteristics of digital tech businesses

This chapter sets out some of the recurring characteristics of digital tech businesses in the UK, including business models, use of freelancers, remuneration strategies and the challenges typically faced at various stages of growth. These characteristics help to explain or provide context for certain findings in later chapters.

2.1 Overview of typical business models, working practices and ownership structures

2.1.1 Range of business models and how these evolved

Across the interviews, there were a range of different business models in operation, including subscription-based, commission-based and simpler product sales models. In several cases, businesses had changed their approach after an initial stage of growth and this was often a natural process as they aimed to scale-up. For example, one small edtech business moved from directly delivering tablet-based learning sessions to schools when their customer base grew and started offering their tablet based tools to the schools to run their own learning sessions. This change freed up the business owner’s time so they could continue to seek new customers and further grow the business.

There were also various reasons for businesses that were historically non-digital to transition into the digital sector. These included simply feeling there was a need to keep up with the changing times or seeing other competitors offering digital products or services. Transitioning businesses also responded to client demand for digital services (particularly in traditional advertising and marketing outfits, where clients were seeking a full service incorporating a digital offer), and as a way of growing the business more quickly through a new revenue stream.

Case study 1: transitioning to being a digital tech business

A small advertising and marketing business, founded 30 years ago, transitioned to being a digital tech business after clients demanded digital services to be incorporated into a package they could offer clients. Now the business makes 40 per cent of its revenue from digital work such as web development and other technical skills that they have kept in-house. The business reported that it was not a specific decision to evolve the business in such a way, rather a gradual one driven by wider change.

At the same time, there were other digital tech businesses that were trying to sell entirely new concepts, products or services, and therefore had the added challenge of trying to establish and grow a marketplace that previously did not exist. One transitioning business specialising in customer relationship management felt they were moving into an immature marketplace, where there was no established pricing structure, so they had ended up changing their pricing three times and tried two different subscription models over the past three years.

2.1.2 Use of contractors and freelancers, and being tech-dependent

A common characteristic across born-digital businesses was a high use of contractors and freelancers. This was particularly the case while they were small businesses and were less able to afford permanent staff with technical skills – and was seen less among mid-sized businesses. Choosing freelancers over employing staff on the payroll was done for a range of reasons. Some start-ups, especially those who were introducing a relatively new concept, product or service – and therefore needed to establish a new market for their offer – did not want to commit to employing staff before they had a sustainable customer base. Using freelancers in these cases was felt to be more flexible while growing the business to the point where sales were more sustained. In a reverse example, one small media and entertainment business moved from having permanent employees, shares and company benefits to solely using freelancers on a project-by-project basis, as a result of reduced business and needing to streamline.

Some small business owners also did not want to employ staff early on to avoid the perceived burden of researching and setting up systems around PAYE and automatic enrolment (both examples raised in certain interviews). Freelance set-ups also enabled businesses to work more easily with individuals based abroad, which was a common occurrence across the digital businesses interviewed.

Furthermore, not all digital tech businesses had in-house technical expertise. These *tech-dependent* businesses had founders, without a technical background, who had come up with the business idea or concept, then needed to outsource the technical development (e.g. developing a website or online platform) to another software developer. Using freelancers gave these businesses access to the specific technical expertise they required.

Those digital tech businesses based in shared working spaces or in regional digital hubs were therefore sometimes at an advantage, as they could more easily find people or organisations with which to partner. It also meant that the businesses that were more *tech-capable*, and had these skills in-house, were also felt to have an inherent advantage. For instance, one small digital media and entertainment business reported that they knew a competitor who had a software developer within their founding team. They felt that this other business would have found it easier to seek early-stage investment than they had, by being able to show investors a developed website, rather than just the concepts. Consequently, they felt the other business would have had more flexibility to adapt their platform as the business grew.

2.1.3 Employee remuneration

Businesses' remuneration strategies related to their ability to retain and attract staff. For smaller start-ups in their early stages, typically running at a loss, it was common for directors to take minimal or no salaries and for permanent staff to be paid below the market rate. In these cases, businesses came into competition with more established and larger businesses that were capable of offering developers a higher salary. For example, one business located in Manchester struggled to retain staff in the same city as several large media organisations – they had recently lost their lead developer, who could offer them a 40% salary increase. In other instances, though, the unique opportunities of working for a start-up was felt to compensate for lower salaries.

"People come to work for a start-up because they get increased responsibilities and they want a challenge. In theory, in a company like this, you will work hard and you will do that for a lower salary."

Small digital media and entertainment business

There were instances of businesses offering share options in addition to salaries, with Enterprise Management Incentives mentioned as a popular choice. Tax was typically not an overt consideration for offering shares – rather, they were felt to compensate for lower wages, reward employees' time and contribution to the business, and to give key members of staff strategic input into the business. Share options were typically offered by more established businesses as opposed to early-stage start-ups. Indeed, one of the reasons why smaller businesses tended not to offer shares was because the business was already run by those committed to the business – thus reducing the need for loyalty incentives.

Where share options were not used, it was because stakeholders or owners did not want to further dilute control of the business, or felt that the benefit of offering shares was limited at a time when their business was so small.

2.2 Challenges faced by digital tech businesses

The challenges faced by digital tech businesses were similar to those faced by all start-ups, but issues around accessing finance and establishing a consistent customer base were more acute for those operating in the digital space. There was a sense among businesses that both investors and consumers were still catching up with technological innovations. This was particularly the case for those digital tech businesses operating in an entirely new market and, for these **ground-breakers**, the challenges were even more acute:

Ground-breakers were those operating in an entirely new market or addressing a problem that had previously not been (or could not be) solved. For example, one e-commerce and marketplace business was designing online avatars to assist with purchasing clothes online.

Facilitators were those seeking to facilitate or replace existing products or services with a simpler, cheaper or more convenient alternative. For example, fintech businesses specialising in online accountancy services, as well as transitioning businesses fell within this group

2.2.1 Achieving proof of concept and securing finance

Businesses relied on funding to develop marketable products or services. Several businesses reported lengthy development phases and as a result, they commonly relied on government support such as Research and Development (R&D) Tax Relief to enable them to develop a product that was ready for market. Due to these long development phases, it was typical for businesses to remain unprofitable for a number of years. For example, one small digital media and entertainment business took three years to become profitable, as they focused on developing a market-ready product and building a customer base.

The challenges around securing investment varied, depending on digital tech businesses' stage of growth. Accessing seed investment was particularly difficult for **ground-breakers** as they lacked proof of concept in the form of pre-existing models that could demonstrate the potential of the business to investors. As discussed, this was particularly problematic for *tech-dependent* businesses who needed to bring in expertise to develop a prototype to secure funding – and who needed funding to source external talent in the first place.

Some participants felt that traditional banks, in particular, were unwilling to invest in digital tech businesses because they were considered high-risk and because it was harder to value intellectual, rather than physical assets. In one example, a fintech business that facilitated Bitcoin exchange said they had been consistently refused a business bank account. This had other repercussions for the business – in their experience, it also made getting a workplace pension provider more difficult, as UK pension providers had also told them they needed a UK bank account for making pension contributions. In this specific case, the business felt that traditional banks viewed Bitcoin as a threat and this was partly why the banks had refused their custom.

"Fintech and bitcoin [are] trying to disrupt established financial services and therefore they're taking business away from the banks... You've got this scenario where you're Henry Ford and you've got all these cars, but before you can operate you need to get permission from the 'Horse Drawn Carriage Society'."

Small fintech business

Certain businesses were also looking for the *right* investor, at various stages. For those businesses with more of a social ethos (commonly in edtech), it was important to find someone who shared their values of increasing access to educational technology, as opposed to being predominantly motivated by profit. For more established businesses looking for subsequent rounds of investment to further develop their product or service, or to expand abroad, finding the right investor was important for the advice and for the level of funding they could provide.

"In our last round, we could be much more selective... We went for investors who were more complementary to the business – who weren't looking for a quick exit and had the specific skills we were after."

Mid-sized fintech business

Transitioning businesses typically did not seek investment to grow their digital revenue streams. Rather, this grew organically or where development was required, funding came from their traditional revenue.

Case study 2: seeking the right amount of investment

One small app and software developer felt that the UK lacked investors willing to invest a middling amount (which they put at £10 million), compared to the US. Consequently, businesses either had to seek several smaller amounts from investors, or look to venture capital (VC) funding. They were keen to avoid VC, as investors typically sought significant control over business decisions (to mitigate the risk they were taking).

2.2.2 Finding customers and clients

Another key issue for businesses in their early stages was accessing their target market. This was, again, more challenging for **ground-breakers** who had the additional challenge of explaining what they were selling to customers, and then trying to convince them of its worth – attempting to prove value and gain interest in something consumers did not know existed. For **facilitators**, where consumers were more familiar with what was on offer, the challenge was how to set their product or service apart from their competitors.

Small start-ups also tended to lack sales and marketing knowledge, having focused their staffing resource on technological expertise. As with tax, dealing with sales was initially the remit of some founders, but as the business grew this became increasingly unsustainable. Furthermore, founders typically lacked the skills needed to effectively close sales or knowledge of procurement. To compound this, small start-ups typically did not have the budget to bring in sales support or marketing expertise.

"This is the thing about small tech start-ups… If you had £1million to chuck at advertising, or there are the viral effects of just being a big company, being a big name … But we have to find that critical mass."

Small edtech business

Where consumers were aware of a business's product or service, a further hurdle was consumer expectation that technology-based items should be cheap, or even free. Businesses explained that the prevalence of free technology in the entertainment sphere has resulted in this perception, and one business felt that this made it increasingly difficult to make money outside of big data or advertising.

"If you sell a house then everyone understands that a house has a roof, windows and whatever, and you buy the house. With technology, that's not always the case, with technology it's like 'why should I pay for this?' because 'this is a service that should come free to me'."

Small edtech business

For those with an established customer base, challenges centred around continued engagement. For example, one small fintech business felt they were capable of rapid growth, and their challenge was to resist this temptation. They were concerned with continuing to grow in a controlled manner so that they could maintain their co-creational relationship with their clients, whereby they updated their crowdfunding platform based on feedback. Another mid-sized digital advertising and marketing business also felt there was a challenge around balancing keeping existing customers happy and attracting new ones.

3 Enabling business growth

The chapter explores how well businesses feel the tax system fits in with their experience of growth. It will also consider their ambitions for future growth, and sources of support and guidance they turn to in relation to growth.

3.1 Ambitions for future growth

Of the digital tech businesses that were interviewed, it was typical for business owners to maintain a short-term focus in relation to their future plans for the business, commonly looking towards the next one to three years. The rationale given by owners was that their industry was volatile, and it was important to remain agile to adapt to rapid changes in the market. Common ambitions emerged:

Those who had **ambitions to eventually sell their business** were primarily concerned with profitability and stability. Where owners had such ambitions they typically had previous experience of building digital tech start-ups and moved from one idea to the next, or simply wanted to reduce their active involvement in the business. For example, the founder of one small fintech business had no net assets, having invested all of his savings into the business, which was rapidly growing. His ambition to sell the business was motivated by the desire to recoup his investment and exit the business with a small stake, allowing him to buy a property for the first time.

Businesses also aimed to **expand abroad** – either to do so for the first time, or to expand their market reach if they already had overseas operations. It was common for born-digital businesses to expand overseas when they were still relatively small – in terms of staff size and turnover. Business owners felt that being technology-based allowed them to operate overseas with fewer resources than more traditional businesses. The fact that certain businesses began overseas operations relatively quickly, meant that their tax affairs became more complex and this proved problematic for those who lacked previous business experience, or who had not yet scaled their recordkeeping systems (see Chapter 4 for more detail).

Other businesses aspired to **increase their staffing levels**. For tech-dependent businesses, this typically meant bringing expertise in-house, and those who wanted to expand their consumer base planned to bring in sales support or marketing expertise. Additionally, those who wanted to expand abroad considered the need to have local knowledge and support. Generally, owners hoped that revenue would increase in such a way that would demand extra support be brought in. In one case, a founder wanted to increase their staff numbers primarily as a result of the societal benefits of more people being employed.

As discussed, a common characteristic of digital tech businesses was the length of time it took for them to become profitable. Business owners did not expect to become profitable quickly and those in such circumstances did not express their current lack of profitability as a concern. As covered above, important aspirations for businesses were to grow – either by reaching new markets, developing their technology or hiring more staff. **Profitability was therefore seen as an organic aspiration**, or a secondary focus, once other ambitions had been realised.

3.2 Sources of support on growth

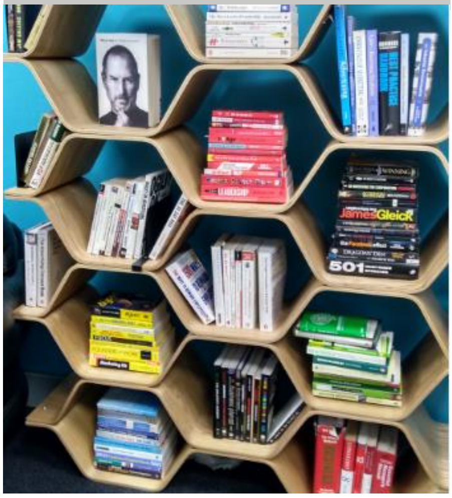
3.2.1 Local networks for informal support

The support that businesses accessed varied depending on their size and stage of growth, and tended to evolve as their needs changed. Those who relied on local networks were characteristically small start-ups, who shared advice, challenges, news on funds and schemes and, in some cases, workspaces. Businesses also shared their experiences through social media and online forums and these informal networks appeared to be more popular than formalised processes – local growth hubs were not mentioned by businesses in the interviews.

"If you look at the London Start-ups group on Facebook, for example, that group everyday has 10 to 15 posts, of which five or six are pointing you to some support or guidance."

Small app and software development business

Photo from a shared workspace of digital tech businesses



Location appeared to be an important factor, with certain businesses mentioning that it was more difficult to form networks and access informal help generally outside of London (though Manchester was also mentioned as a particularly supportive region for digital tech businesses). As well as being able to access informal support, having an office near other digital tech businesses enabled face-to-face working with developers, which was particularly important for *tech-dependent* businesses.

For example, one mid-sized digital media and entertainment developer explained that they could no longer afford their original office due to business rates and high rent in London. They worked in the same vicinity as other digital tech businesses and frequently shared experiences and resources, including recommendations on bringing in freelance technical expertise. When they moved, they felt that they lost this support.

There were also examples of localised business support – including regional funds, that typically required businesses to remain in the area and hire local talent as a precondition for funding. Specific support schemes were also mentioned, such as Scottish Enterprise's provision of £1,500 to one e-commerce and marketplace business to help with their cyber security. This business also received support developing a business plan, which they felt helped them to hire staff and attract graduates. However, there was a suggestion that these regional schemes seemed less assured than national provision – in one example, a scheme offering local business rates relief in Bristol was withdrawn, and the app and software developer had to pay back what they had saved.

3.2.2 Tailored and formal support

Businesses also proactively sought advice from more formal sources, about specific challenges they faced or ways to grow the business. As discussed, choosing the right investor who could provide specific guidance was important to those in the position of being able to select investors. Angel investors and those associated with regional or national funds were approached for guidance, in addition to their financial contribution.

For example, one small digital media and entertainment business received help from their investor on employment contracts, when they took on permanent staff for the first time.

Non-departmental public bodies (NDPBs) were also sources of advice for certain businesses, however HMRC were rarely associated with such support. For digital tech businesses, HMRC's perceived remit was one of tax collection rather than providing guidance on growth. Certain businesses looking to expand abroad or secure investment from overseas mentioned contacting UKTI[11] for information.

For example, one small edtech business contacted UKTI to discuss a potential Chinese investor. UKTI sent a trainer to their office to enable them to negotiate a successful deal.

For some businesses, universities were also an important resource. There were examples of businesses locating their offices in university towns in the hope of attracting talented graduates and forming relationships. One small app and software developer based themselves in Birmingham for this reason, and had hired several software engineering graduates as a result.

3.3 Perceptions of being a UK-based tech business

3.3.1 Attitudes towards tax reliefs

Businesses were made aware of tax reliefs through their accountants, personal networks, or because of their experience within the technology industry. Reliefs were seen as key to driving growth and to help businesses negotiate some of the challenges outlined in earlier sections. As such, it was important for founders that reliefs were utilised early on in development and that the relief was received quickly. This was particularly important for those with an unreliable stream of income, for whom reliefs were crucial to managing cash flow.

"It's the sort of thing that has kept us going. We need both SEIS and EIS and VGTR[12] and the R&D tax stuff that we've done as well… That has massively been the life blood that's kept us going long enough to reach this stage where the B2B deals are happening and the business can thrive."

Small edtech business

Two government schemes – SEIS and EIS – were particularly well received by businesses, who felt they had helped them to attract investors. For example, businesses reported that it was not unusual for potential investors to ask whether the scheme could be used as one of their first questions. In addition, the application process was felt to be relatively straightforward, which was especially important for typically time-poor businesses.

Businesses who had used the schemes felt that the thresholds should be raised in order to be more in line with what it realistically takes to build a digital tech business – a view particularly common amongst **ground-breakers**, for whom investment was needed to fund characteristically longer development phases, and where challenges in attracting investment were more acute. Those businesses felt that raising the threshold would enable them to focus on development and avoid rushing out a product that was not market ready, as a result of funding running out.

[11] UK Trade & Investment was replaced by Department for International Trade in July 2016, but we use the language employed by participants in this report. DTI are the government department responsible for promoting British trade around the world and ensuring the UK takes advantage of trading opportunities globally.

[12] Video Games Tax Relief (VGTR) is one of seven creative industries reliefs in the UK tax system, offering UK video games developers tax relief on a proportion of the development costs of qualifying video games. See the GOV.UK website for more information: https://www.gov.uk/guidance/corporation-tax-creative-industry-tax-reliefs#video-games-tax-relief-vgtr

Research and Development (R&D) Tax Relief was also felt to help businesses that would naturally struggle to demonstrate proof of concept and that, without it, founders would have had to increase the amount they had personally invested in the business. R&D Relief was also felt to mitigate, to an extent, against unsuccessful ventures.

JUN

Case study 3: R&D compensated for time spent on technical challenge.

One small app and software developer had been claiming R&D Tax Relief, but faced a technical challenge that they spent four months trying to resolve, before they realised it was insurmountable. The benefit of the relief was that they could still receive finance for some of the time they had spent on the project, rather than it being a complete waste.

However, the complexity of applying for R&D Tax Relief was cited as a criticism by those who had used it, with founders feeling they could not navigate the process themselves. Consequently, businesses would outsource the process to their accountant or, where their accountant lacked experience in this area, they would hire a specialist R&D consultant to complete the form on their behalf. Such specialists charged commission for this, with one digital advertising and marketing sole trader agreeing to 25% commission on a three-year deal.

"I found the whole thing completely impenetrable, but they were able to put the form together."

Digital advertising and marketing, sole-trader

Furthermore, the perceived complexity of the application process was sufficiently daunting as to put certain businesses off altogether. These businesses felt there would be a low return for their time spent on the application and instead focused on developing the business and growing their customer base.

3.3.2 Perceptions of foreign markets

Those working in foreign markets had some experience of how digital tech businesses were supported elsewhere. A common sentiment was that US markets were more open to risk and consequently were preferred for seeking investment – as opposed to UK investors who were felt to be more risk adverse. **Ground-breakers** were more likely than **facilitators** to have this perception, given the heightened challenges they faced around lack of precedent and securing initial investment.

However, one fintech business felt that the complex tax rules in place in the US made it a much less attractive prospect than their current UK customer base. They felt that in the future they might bring in expertise to help them negotiate these complexities, but were not yet in a position to do so.

"When we are ready and when we have the resources we would want to go … At the minute, simply it stops because of tax and you just don't want the complication."

Small fintech business

Other businesses looked to Asian markets, where the potential customer base was seen as extensive and hopefully lucrative. As well as being able to pay lower salaries, compared to the UK market rate, two businesses mentioned specific incentives they thought were available to businesses in Singapore. According to one small e-commerce business, businesses are exempt from paying tax on their first three years of profit – something they saw as having merit for two reasons. On the one hand, they felt such a scheme would allow businesses to reinvest profit into developing the product or service, and on the other, it would generate more income from tax on a longer-term basis.

A second mid-sized business in digital media and entertainment understood that there was a scheme where the Singapore government would pay 50% of staff salaries where local engineers were employed, and another where funds were available to cover up to 90% of the costs of staff training.

4 Managing tax requirements

This chapter explores the systems and processes that digital tech businesses have in place to manage their tax requirements and how they have changed over time. In addition, it looks at their understanding of their obligations, where they go to for support and advice, and their awareness of HMRC's digital and online focus.

4.1 Division of tasks in-house and externally

4.1.1 Recordkeeping usually done in-house

Across a wide range of businesses of all sizes, recordkeeping was typically managed in-house. In start-ups, the business owners or Chief Executives often felt they could not justify additional spending on recordkeeping, so aimed to oversee it themselves. In more established businesses, internal admin staff were paid to deal with this – as these businesses typically had the steady growth and solid customer base needed to sustain the business. One exception to this was a small business whose owners felt they were spending an inordinately large amount of their time on recordkeeping, taking them away from website development. They planned to outsource recordkeeping to their accountant later this year. The other exception was a mid-sized business, where recordkeeping across all their global offices was done by a central finance team at another European office.

There was widespread use of accounting software for recordkeeping among digital tech businesses, as it was felt to ease the burden of recordkeeping and allowed businesses to deal with foreign currencies. More generally, participants felt that using software fitted neatly with their nature as digital tech businesses.

"I think that's probably a difference between us and traditional businesses: because we're all online, all of our accounting and financial management is integrated within our platform."

Small digital media and entertainment business

Photo from app and software developer

Several programmes, such as Xero and Sage, were mentioned in interviews.[13] Software that was cloud-based or adapted for mobile apps was considered especially helpful, as it allowed tech business owners who travelled frequently to keep a record of receipts on the move. It also allowed businesses transitioning from non-digital to digital revenue streams to keep track of both. Where business models centred on an online platform, software also appealed as it could be integrated with online bank accounts, running as a single automated process.

"The software syncs your bank account with the platform and just sucks it all in. There's no cornflake box stuffed full of receipts."

Small e-commerce and marketplace business

However, in businesses where recordkeeping was overseen by the owner, there were cases where their time and money was primarily focused on other areas of the business (such as building up the customer base). Recordkeeping was deprioritised and they were less confident about their compliance as a result. In addition, there were examples of these businesses still using paper. They were typically smaller

[13] Other brands mentioned included SafePay, Receipt Bank, FinancialForce, FreeAgent, Float and Clear Books.

start-ups, who again had not taken the time to consider, or money to invest in, a more efficient recordkeeping approach in their early stages. This will be covered in more depth later in this section.

4.1.2 Use of accountants

Digital tech businesses typically used accountants for filing tax returns. This is because business tax in general was considered complex enough to warrant expert help, to ensure mistakes were not made, and businesses typically lacked in-house expertise to do their returns themselves.

"Trying to do tax returns yourself … that's just never an option. There are too many moving parts. You've got to get it correct, and … the team here have more important things to do."

Small digital media and entertainment business

"None of us felt comfortable with this area, none of us felt like we would do a professional, good job, and if we did it would be at huge effort – a huge stretch which would just distract us from our main challenges."

Small edtech business

Businesses felt it was important to have financial support, in some capacity, with their taxes and, as such, hiring an accountant was often one of the first spending decisions that businesses said they made. This contrasted with the deprioritising of recordkeeping among some start-ups – there was a sense among some of these businesses that their accountants would naturally alert them to any problems with their recordkeeping before submitting any returns, so they (the owner) did not always need to stay on top of it themselves.

Among these businesses, there were examples of owners expecting their accountants to ensure their affairs were in order, and later discovering that this was not the case. These businesses were heavily reliant on their accountants and errors typically arose as they delegated complex tax processes to their accountants. Where errors were made, they were often the result of poor communication between businesses and their accountants. Typically, these businesses had incorrectly assumed they had deferred responsibility to their accountants, as well as delegating the specific task.

For instance, in one small edtech business, the external accountant had mistakenly claimed a rebate for the business, when it had already been claimed once through a self-assessment return. In a second case, the external accountant for a small digital advertising and marketing firm had frontloaded the National Insurance (NI) allowance for the directors, so that when NI payments started six months later, this was a major shock to the business's cash flow. A third business was in the process of changing accountants and, in the transition, had ended up being fined for a late VAT submission, as neither accountant was dealing with this.

"That's our problem for [using] a third party, rather than managing it ourselves… If I'd handled it myself, if I felt confident, I'm sure I could've handled it directly with HMRC and wouldn't have had any problems."

Small edtech business

On the other hand, there were a group of participants who felt it was important they understand how their business was performing at a strategic level. These tended to be those associated with more stable businesses, whose day-to-day role was to grow the business rather than 'get it off the ground' in the first place. These participants took a more active role, for instance in reviewing figures from their accounting software, or monthly management reports from their accountants. As part of understanding business performance, these owners felt they had a greater oversight of the business's tax affairs (but typically still used accountants to ensure accuracy of reporting).

"I oversee everything and make sure everything's running. We've got systems in place to make sure that VAT filings and payments are happening at the right time. We regularly have conversations about how the company's doing."

Small app and software development business

4.1.3 Use of specialist advice

There were also businesses that employed organisations such as management accountants, separately from their regular accountant, to advise on strategic business performance (for example, tax efficiency or cost-savings).

These tended to be established businesses who could afford ongoing strategic support, but were not big enough to have in-house finance teams. For example, one mid-sized fintech business, running a peer-to-peer consumer lending platform, used a regular accountant to ensure their accounts, Enterprise Management Initiative shares and VAT returns were correct, and had also previously sought strategic advice from a multinational accountancy firm. However, as a mid-sized business they now felt they had this strategic expertise in-house, so no longer needed to use external agents (but retained their regular accountant).

There were various other reasons across the interviews for using external accountants or agents for strategic advice (i.e. beyond filing of tax returns):

- Those whose businesses had grown especially rapidly wanted a better understanding of their management accounts to inform decisions about the future direction of the business
- Owners with long-term ambitions to sell their business wanted a better understanding of their current position, prospects and advice on how to grow the business – specifically to be in a position to sell
- Specialist tax agents were also used to apply for financial support (e.g. R&D Tax Relief, SEIS and EIS).

Case study 4: seeking strategic advice on tax

A small fintech firm offering digital banking consulted with a big-four accountancy firm to review their structure from a tax viewpoint, to ensure they were tax-efficient from the beginning and did not make costly errors later. They ended up creating two companies – one dealing with the banking side of the business and the other tasked with developing the software and platform. The latter company was then eligible for support under the Seed Enterprise Investment Scheme (SEIS). The focus on their structure at such an early stage was particularly important for them because, as a bank, they would be tied to a specific legal structure, and would not be able to change this in later years. The founders also knew this from their previous experience working in the non-digital banking sector.

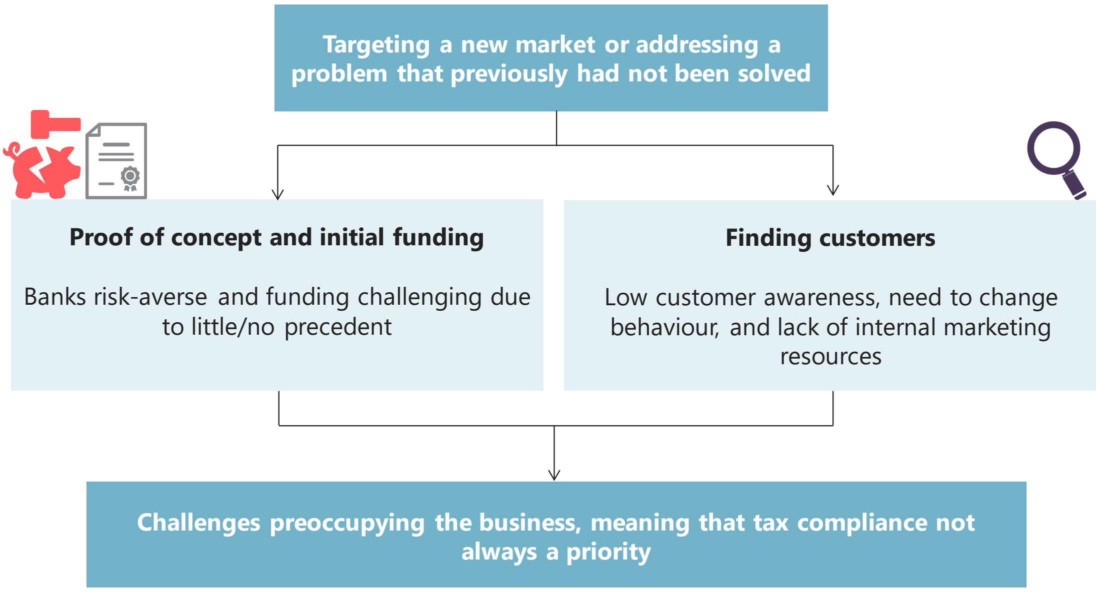
4.2 Improving tax processes with business growth

4.2.1 A proven business model and owner experience

Businesses' processes for managing their tax requirements typically changed as the business grew. Where businesses started out with scalable systems (such as software), they were typically headed by individuals with previous business experience who understood the importance and value of investing in recordkeeping, to understand business performance.

Knowing that the business was sustainable also influenced when recordkeeping systems were improved. As outlined, this challenge was felt more acutely amongst **ground-breakers**, as owners could not be confident they had a viable model, product or market. This had implications for their ability to manage their tax affairs on top of their day-to-day workload, and the challenges associated with establishing a viable business (Figure 4.1) were prioritised over their obligations.

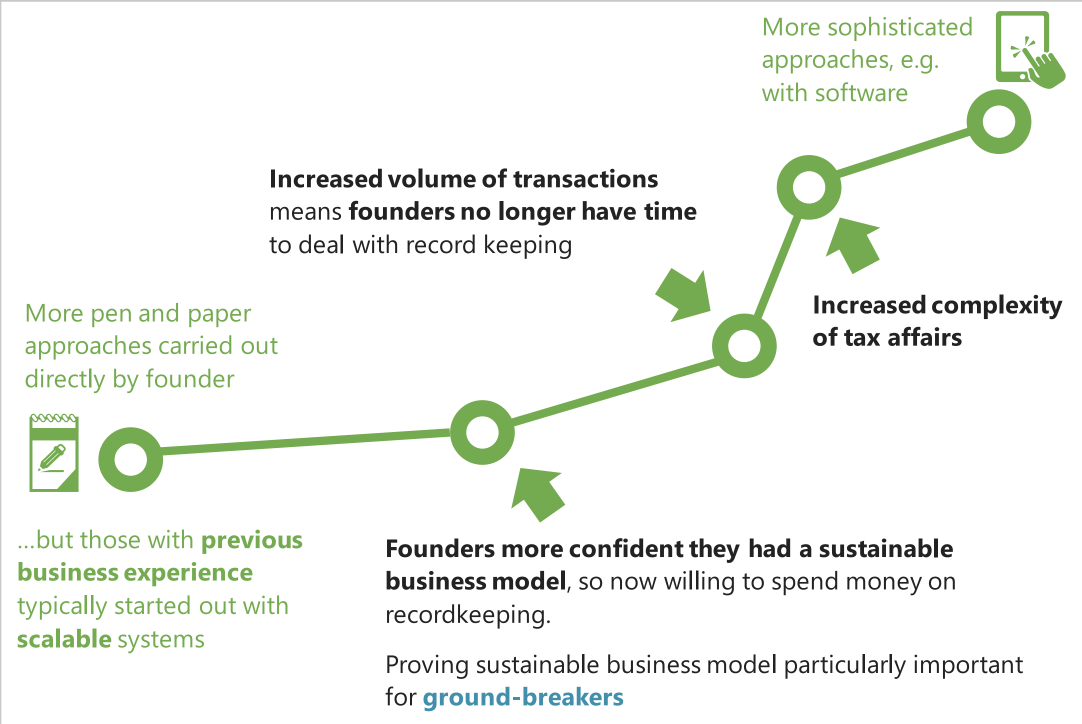
Figure 4.1: Challenges facing ground-breakers, and implications for tax management



In these situations, founders were commonly responsible for recordkeeping and were reluctant to invest in the payroll costs of internal admin support, or in software, when the future of their business could not be guaranteed, or when margins were tight. For example, one edtech start-up stored receipts and invoices and passed them on to their accountant before deadlines, for their first two years of business. Whilst the accountant advised them to use software, the owner was reluctant to invest when they had not yet built up an established customer base. They began to use software when they started seeing steady monthly payments and felt they could justify the expense.

It was not the case that processes changed as businesses grew from small to mid-sized, as there were examples of both small businesses starting out with scalable systems, and established mid-sized businesses having to improve their systems after several years of trading. Several tipping points are shown in Figure 4.2 and discussed in turn, below.

Figure 4.2: Milestones in growth journey, leading to better tax management



4.2.2 Increased volume of transactions/expansions

Founders commonly felt that growth simultaneously made recordkeeping more difficult for them to manage themselves and made it *more important* to stay on top of. As businesses looked to expand abroad, take on more staff, or approached new tax thresholds, being able to easily extract data to understand cash flow was considered essential for informing management decisions.

For example, recordkeeping was becoming increasingly unviable for one founder of a business to manage – as their plans for expansion abroad needed his full-time attention. The founder was spending a substantial amount of time on recordkeeping: manually recording transactions in Excel to work out their (taxable) commission. They planned to outsource recordkeeping to their accountant later in the year.

"It's just not easy to extract the data you need to understand cash flow. I can't use it as a day-to-day management tool. Why is it that complicated and time-consuming that I have to pay someone to do it?"

Small e-commerce and marketplace business

There were also examples of businesses having to improve their methods of recordkeeping to cope with increased sales and transactions – particularly, as in the example above, where elements of the process were highly manual. One mid-sized fintech business that handled international money transfers previously used software for their recordkeeping, but found that the software was unable to cope as the number of transactions increased. Consequently, they built their own in-house financial database, which integrated fully with their platform.

4.2.3 Increased complexity of tax affairs

Those without scalable systems also changed their processes as their affairs became more complex, and owners wanted software or admin support to help them manage these added complexities. As a result of hiring permanent staff for the first time, one app and software development owner decided to move from a spreadsheet for recordkeeping to software. The owner wanted software for its greater functionality and to be able to manage the added complexity of PAYE.

Expanding internationally was also a trigger for those without scalable systems to review their processes. For instance, one small digital media and entertainment business was in the process of moving from Free Agent to Xero accounting software, as they had heard anecdotally that the latter was much better at handling and reconciling overseas transactions. In these cases, owners wanted the reassurance of software to ensure they were handling cross-border tax and foreign payment issues correctly.

Finally, there were also several cases of businesses changing their accountants as they grew. One mid-sized Digital media and entertainment business moved from their original tech-specialist accountant to a larger, multinational accountancy firm as they grew and expanded abroad. They felt that they no longer needed advice and auditing as a tech start-up, but needed accounting support more suited to an internationally trading, mid-sized business. For others, the decision to change their accountants was likened to an 'upgrade'.

"As the business grows, you can afford better support. I'm fairly sure that to find our first accountant, someone Googled, 'cheap accountant UK'…."

Mid-sized fintech business

4.2.4 External pressures

There were also examples of businesses changing their systems as a result of outside influences. One small e-commerce and marketplace business was told to hire an accountant to ensure the accuracy of their management accounts by their board of directors. The business was growing and the founder felt he had become too busy to manage this properly himself.

A second founder at a mid-sized, transitioning business previously managed payroll and the business's VAT returns. He submitted his returns late on several occasions and subsequently received fines. The owner acknowledged that the fines prompted him to hire an office manager.

4.3 Ease of managing tax requirements

4.3.1 Businesses' understanding of their tax obligations

As discussed, in businesses where recordkeeping processes had not been reviewed in relation to their scalability, certain owners were less confident about their compliance. These owners typically lacked prior business experience and were primarily focused on developing other areas of the business, such as product development, increased sales, or building a customer base. Where businesses' focus was elsewhere and/or owners had delegated responsibility to their accountants, there were examples of mistakes made in relation to tax.

One mid-sized fintech business experienced rapid growth and had not prioritised hiring in-house accounting expertise as a result of focusing on growth. When they were a small business, they were unaware that they needed to be VAT-registered, and as they grew, did not know the tax-implications of their company benefits and were also unclear on employer taxes. This was flagged by an auditor and they made two voluntary disclosures to HMRC.

The accountant of one small business asked the founder early on whether they would prefer to be set up as an employee or a director. The founder chose to be an employee without realising there were any tax implications. Subsequently, the business missed a PAYE payment, as the founder did not realise they would be liable.

At an edtech business, all the members of staff were freelancing. A potential investor flagged that they should be registered for PAYE and become employees as they were working four days a week and this was their main employment. The investor also advised that they should be registered for VAT.

Views on the ease or difficulty of managing recordkeeping and tax requirements, in general, were mixed. But, broadly speaking, those who were more established or whose owners had previous business experience found their obligations less burdensome than newer, more inexperienced start-ups – as they had been through several accounting cycles and were more familiar with their obligations.

4.3.2 Automation and integration

Those with multiple systems for recording transactions found their recordkeeping more burdensome. Commonly, this involved using software for recordkeeping and a separate spreadsheet to understand business performance, perform manual reconciliations not permitted by the software, or to deduct taxable income. These businesses felt the burden was expected to increase with growth – as they had to monitor an increasing number of transactions.

Case study 5: Manual process creating significant burden

One small digital media and entertainment businesses used Xero for bookkeeping and a spreadsheet to understand sales – such as performance against projections, and profit margins on specific artists or genres. The recordkeeping software did not have the functionality to permit these business performance tasks.

The owner of the business subsequently spent two hours a day using the software for their recordkeeping and one hour a day to update the spreadsheet. This burden had increased in direct proportion to sales, and the owner wanted to pay their external accountant to do their recordkeeping for them in the future.

It was common for those with manual processes to consider outsourcing their recordkeeping, or to look at automation in the future. Automation involved developing technology that could replace processes carried out by people within the business, freeing up their time to focus on growing the business. Outsourcing or automation were aspirations that would only be feasible when owners felt that they could justify the expense, or the amount of time individual owners were spending became unsustainable.

"If the numbers increase, we'll have to change our processes. It's highly manual right now. But that's what funding is for – we would automate stuff more as we grow."

Small fintech business

Those who had already invested in automation felt that it had reduced the burden of recordkeeping and financial management, and typically had a consistent revenue stream that justified the investment. Examples included moving to software that integrated with online platforms, bank accounts or client relationship management software (CRM), removing the need for manual reconciliation.

"It's never easy, but it's getting easier, as we're more automated, and as HMRC gets more automated."

Small e-commerce and marketplace business

For example, one transitioning digital advertising and marketing business had been using spreadsheets to record and understand their client work with a view to analyse business performance. They realised that it would be quicker, better and cheaper to use an automated system to do this. As the owner had a background in technology, the business developed algorithms and employed machine learning techniques to analyse their client data, which now saves them time and avoids human bias.

4.3.3 Burdens associated with obligations

Across interviews, **digital tech businesses often mentioned VAT and payroll taxes being the more difficult parts of their tax processes**, and some felt the tax systems around these were not designed with digital start-ups in mind. By contrast, Corporation Tax (CT) was rarely mentioned, as those who reported struggling with these obligations were typically early-stage businesses and not profitable, and therefore not liable for CT. As discussed earlier, characteristically long development periods meant that digital tech start-ups did not have a market-ready product or service for several years, hindering their ability to bring in revenue. In relation to payroll taxes and VAT, three broad concerns emerged:

- the financial burden of obligations on early-stage start-ups
- obligations affecting competition
- needing more information to fully understand obligations.

For certain businesses, who tended to be those struggling to secure funding or to establish a reliable customer base, **regular payments such as Employer's National Insurance (NI) and VAT made it difficult to manage cashflow**. Those who expressed concerns about Employer's NI felt that the system was not designed with the typical early stages of tech start-ups in mind and felt this could risk harming the country's entrepreneurial base. As discussed, one of the reasons that use of freelancers was so high was to avoid committing to salaries, PAYE and other associated costs, such as HR and automatic enrolment. These businesses felt that a substantial amount of the money they received in investment went to HMRC each month in Employer's NI, a perceived burden that they felt was particularly bad as they were not making profit.

"Of the £150,000 we received in funding, about 15-17% of it went straight out in NI … For a start-up that's not making any profit, to me that seems ridiculous. Much better to try and get this company to be profitable and survive for 20 years paying tax, than kill it off in a year, two, three … Squeezing start-ups for tax is a poor investment in the future."

Small digital media and entertainment business

These businesses felt that, in the precarious early-stages, digital tech start-ups needed every penny they could to build a sustainable business. Employer's NI was seen by these businesses as potentially harmful to the country's entrepreneurial base and it was felt that the system could benefit from taking growth and scale into better account. One business had used a NI holiday scheme, and several more spontaneously raised the concept (without awareness of any schemes). Others suggestions included scaling NI contributions in line with the number of employees, or allowing more flexibility in terms of paying Employer's NI or VAT from one deadline to the next. For example, one business felt that it would be beneficial to over-pay at one deadline, to help manage cashflow around the next deadline.

"If you've got people who are dedicating their lives to this, taking minimal 'beans on toast' salaries, maybe they should be treated slightly differently within the PAYE code."

Small edtech business

VAT was also mentioned as adversely affecting competition – where it was seen as unfair or unevenly applied. For example, several edtech and digital media and entertainment businesses, who offered a product or service either seeking to replace or facilitate an existing concept, noted that certain books are VAT-free whereas digital sales are subject to the 20% rate. When combined with the additional challenge that consumers expect software-based products to be cheap or even free, this particular case was felt to keep the physical book industry competitive and was seen by owners as an 'archaic' practice.

While many of the VAT rules perceived to be unfair also applied to non-digital businesses, they were often a particular focus in these interviews, as VAT was the first relatively complex aspect of tax that many digital tech businesses faced, long before they incurred any CT. For instance, two early-stage fintech businesses mentioned they were ineligible to claim back VAT as financial services businesses, which made their outgoings more expensive. Both felt that being able to claim back VAT would help stimulate the growth of early-stage fintech businesses, enabling them to compete with more established, larger businesses operating in the finance sector.

Finally, other businesses felt they encountered certain obligations before they were ready and **needed more information to help them navigate these added complexities**. For example, it was perceived by several businesses that it was necessary to be VAT-registered, either because they had been advised to do so by potential investors or they were required to do so for certain business-to-business partnerships[14]. These businesses had typically not yet professionalised their tax systems and were heavily reliant on their accountants to ensure their VAT requirements were met. In many of these cases, the founder was still responsible for recordkeeping and the combination of lack of expertise and the perceived complexity of VAT meant that they were less confident in their recordkeeping than businesses with more established processes in place. For these businesses, having a VAT obligation was 'another thing to worry about' when they were primarily focused on establishing the business.

Being tech-based meant that many of the businesses we spoke to could expand abroad whilst they were still relatively new and/or small, meaning that they encountered cross-border VAT rules and the related VAT Mini One Stop Shop (VAT MOSS) scheme (if they had EU customers) reasonably early on in their growth stage. Cross-border VAT rules emerged as a difficult issue, especially for smaller, less established businesses. Some mid-sized, or more established businesses also reported that these rules were complicated, but these businesses were more likely to have the resources and experience in place to cope. One e-commerce business said, for example, that they were aware of other similar businesses having to pay to retrofit their websites to accommodate differential VAT rates.

[14] This reflects the opinion of businesses spoken to during the interviews and **not** policy: registration requirements are based solely on taxable turnover.

They felt they had been lucky in starting up their business around the same time the VAT place of supply rules came into force, so they could consider paying differential VAT rates in the design of their own website from the beginning, but that not every business would be savvy enough to do this.

Those struggling with VAT rules on place of supply, commonly found the policy and information available to be complex, both from accountants, and from their own research online, and wanted working examples or help sheets to be available to guide businesses through the rules and the VAT MOSS scheme. They wanted to know, for example, how to register for the scheme and the implications for their business – particularly the fact that businesses needed to be VAT-registered to use the scheme, even if they are below the UK VAT threshold.

Case study 6: needing more information to understand VAT MOSS

One small digital media and entertainment business below the UK VAT threshold had a website selling music licences and sold to UK and EU customers. They registered with the VAT MOSS scheme, and initially did not realise that they would be required to be UK VAT-registered in order to use the scheme. The owner felt that there was a lack of advice around how to navigate VAT place of supply rules generally, and the VAT MOSS scheme, specifically, for small businesses. In this case, they also reported that their accountant had given them the wrong advice. Ultimately, they came up with their own guidance document and shared this with other digital tech businesses in a similar situation.

4.3.4 Other pain points encountered with business growth

Whilst less consistently mentioned than VAT or PAYE, three further issues were identified by businesses that were encountered as they grew in size (either turnover or staff numbers).

- **Hiring extra staff or permanent staff for the first time** occasionally resulted in payroll queries, including those relating to student loan deductions. These queries took time to get resolved, in part as businesses are unable to speak to HMRC about an individual's tax code, and were not issues encountered by businesses when they had contractors as opposed to permanent staff.
- **Offering company benefits** was occasionally used as a means of attracting and retaining staff. However, businesses without in-house bookkeepers or accountants to handle this aspect found the associated tax requirements to be complex and time-consuming. These businesses wanted to bring in incentive schemes as they grew, and as a means to remain competitive, but felt that the complexity of the paperwork was perhaps more easily handled by larger, more established firms.
- **The Apprenticeship Levy** was mentioned by one business who had set up their own academy to train accountants, prior to the levy's introduction. They were not aware of any specific support or reliefs available to them, and resented paying the levy as a business, when they were already funding their own scheme.

4.4 Sources of support, advice and suggestions for improvement

Where businesses needed support with their day-to-day processes (such as how to allocate expenses on an end of year return), and they did not know the answer in-house, they would typically approach their accountants. As discussed, those focused on establishing or growing their business would delegate tax requirements to their accountant and for those businesses their accountant was the obvious first port of call.

"I really take the lead from the accountant – he'll bang on my door if there's stuff missing."

Small e-commerce and marketplace business

Where businesses approached HMRC with queries, it was typically in relation to a dispute, if they were unable to file or pay on time, or to discuss cases such as tax relief claims or the valuation of EMI share options.

4.4.1 Understanding digital tech businesses

A key factor driving how positive, or not, businesses found their interactions with HMRC was whether they felt HMRC understood their business, and the context in which mistakes had been made. For example, one business that had been unable to pay a PAYE bill on time as they were waiting to receive funding, felt that HMRC did not take the funding delay into account. The business was given 10 days to pay before the case was handed to a debt collection agency. The bill was subsequently paid two weeks later, when the funding came through. The owner felt that HMRC's response demonstrated a lack of understanding of the cash flow pressures faced by early-stage digital tech businesses, and felt they were treated in the same way as a more established business, capable of paying on time.

"They [HMRC] don't care if it's [large multinational] or 'ABC Co.' – a tech start-up."

Small digital media and entertainment business

Another business ended up owing HMRC a Real Time Information (RTI) payment, at the same time as HMRC owed them an R&D Tax Relief rebate. The business owner felt that HMRC were aggressive in their pursuit of the RTI payment, but that the process for receiving R&D relief was, by contrast, a drawn-out process. The owner felt that HMRC did not fully understand the impact of the delay in receiving the rebate on managing their cash flow.

"[You] have a person in an HMRC call centre, making decisions based on 'the system' that could close my business down. It's out of touch with entrepreneurial reality."

Small digital media and entertainment business

Managing cash flow was also problematic for businesses who did not have regular or guaranteed income, and these businesses typically reported finding payments such as VAT or PAYE bills difficult to manage.

"Cash flow is king … on a subscription model, if you don't get that revenue in and you've got to pay your VAT, that can cause quite a lot of work in just trying to manage where the money is."

Mid-sized fintech business

These businesses felt that support offered by HMRC could be improved with a better understanding of these cash flow issues and the impact this had on their ability to comply. Suggestions included:

- Greater leniency in terms of meeting deadlines for filing and making payments, including more flexibility around businesses choosing whether to pay monthly or quarterly, to suit their situation

- National insurance holiday schemes to ease the financial and administrative burden on early-stage start-ups, allowing businesses to focus on attracting investors, customers, or product development[15].

Case study 7: Taking risk and wanting more assurance from HMRC

One sole trader who had patented advertising technology ('Adtech') to protect children from inappropriate media content wanted more assurance from HMRC, as an entrepreneur operating in a high-risk endeavour. He wanted an open dialogue with HMRC where he could outline what he planned to do and the risks he planned to take and assurance from HMRC about the tax implications, whether or not he was successful.

"When I'm busy investing my pension funds and trying to come up with deals – I'm actually risking things. I don't want a situation of just being patted on the head by the authorities, until I'm successful and suddenly I get, 'Oh my goodness me, you've been successful!' and everyone used hindsight to take a look. If I've been taking the risk, I want to take the benefit."

He wanted a relationship with HMRC where they understood the risk he was taking and could help him to plan the tax implications in advance, rather than deciding on the tax implications further down the line.

4.4.2 Digital tech businesses' awareness of their obligations

How productive businesses found their interactions with HMRC also depended on their knowledge of their business's tax requirements. For example, one sole trader who had only had positive experiences of contacting HMRC, believed that this was because he was knowledgeable of his tax affairs and could provide supporting evidence or contextual information to help HMRC.

"On all occasions I've found the staff very helpful – particularly so because I had everything that they needed … I was straight with HMRC, so HMRC had been straight with me."

Sole trader, digital advertising and marketing

This was supported by those businesses who had brought expertise in-house feeling they were now better equipped to engage with HMRC about their tax affairs. One fintech business, specialising in cross-border money transfers, had grown their in-house support from one person to a finance department of six to eight people, headed by a Chief Financial Officer.

"When we had better people dealing with it for us, we got better results from them [HMRC]."

Mid-sized fintech business

As previously mentioned, another fintech business had made two voluntary disclosures to HMRC when they realised they should have been registered for VAT, paying Employer taxes and taxes on company benefits. They said that their mistakes had been made early on, and felt it was as a result of lacking in-house expertise.

[15] One business had made use of a National Insurance holiday scheme and was positive about its impact. However, awareness was reasonably low, with most other mentions being speculative in nature.

"The staff we had didn't even think to ask… if you don't think to ask – no matter how good HMRC's pamphlets are, they'll be chucked in the bin. [We had] a very young team with not much financial expertise."

Mid-sized fintech business

These businesses, again, felt that greater leniency in relation to deadlines and making mistakes would be beneficial. In particular, businesses felt that their experiences of negotiating the tax system could be improved through:

- An understanding on the part of the authorities that admin associated with tax was complicated and time-consuming for those focused on establishing their business, those with limited business experience and those without in-house support.
- Awareness of support available from HMRC was low and businesses often reported struggling to find information on key issues, despite the fact that such information is available online[16]:
- more tailored support for early-stage businesses yet to bring in expertise, to enable business owners to have a better understanding of their obligations and the implications of decisions made early on; and
- more tailored support available for growing businesses, flagging issues such as when to register for PAYE, how and when to make the transition from freelancers to permanent staff, and when VAT issues should be considered. Participants mentioned that worked examples or flowcharts would be particularly useful for understanding how obligations might change with growth.

"There is no easy starting guide. There needs to be a government website like 'Oh, you started a business? This is what you need to know'. There is no 'starting a business's portal, you have to pick it up by hand."

Small e-commerce and marketplace business

4.4.3 Online support and HMRC's digital focus

There was a clear preference for HMRC's support to be more in line with how digital tech businesses operated – namely online, where information could be accessed instantly and used after hours. This preference for online means of communication was demonstrated by suggestions of how to further improve or automate more HMRC processes. The following suggestions were felt to reduce some of the burdens associated with compliance:

- Simplifying the Government Gateway[17] interface and making the login process simpler. Particular pain points included security levels being too stringent, and participants forgetting their login information. The security for online banking was a favourable comparison
- Introducing 'chat bots' or live chat, which was felt to help make support more instantly accessible
- Introducing instant payments by ending cheques and setting up direct debits for payments such as PAYE bills. Participants felt that this would help businesses ensure they paid on time.

[16] See: http://www.hmrc.gov.uk/courses/SYOB3/syob_3/html/syob_3_menu.html and https://www.gov.uk/set-up-business)

[17] 'Government Gateway' was typically the language used by participants – few had heard of the 'Business Tax Account'

"There has to be an easier way of doing those payments. Why can't it be automatic? I am happy for it to automatically come out of my bank account."

Mid-sized digital media and entertainment business

Despite their preference for online and automated processes, awareness of HMRC's digital focus – namely Making Tax Digital (MTD) – was low. Businesses who had not heard of MTD were broadly receptive to the idea of reducing paperwork, and moving to quarterly updates[18].

"Being a tech person and a finance person ... I believe that software can be a genuine solution to a lot of processes ... Investment in tech and digital is a huge opportunity to make sure there is a state of the art, world class tax regime."

Small fintech business

Two businesses had heard of MTD and were positive about the changes. The first was a sole trader who was in the process of changing his software to Xero in preparation for MTD. He felt that quarterly returns were moving closer to real-time reporting and was in favour – as he felt this would facilitate greater transparency for the authorities. The participant felt that complete and accurate tax records, filed on a timely basis, was one to prevent cybercrime against businesses, having formerly dealt with this in a professional capacity.

The second was a digital accountancy firm specialising in software and support for small businesses. They had been in discussions with HMRC about the requirement to use software and felt strongly that MTD would simplify tax returns for businesses, and would mean greater transparency and accuracy of reporting.

"How does the government possibly manage cash flow when they don't know what they might get at the end of the year? By doing it quarterly, it makes sense: they know what's coming in."

Mid-sized fintech business

[18] Businesses were provided with a very brief definition of MTD and the impact it may have on their business was not discussed in depth. Their top of mind reactions were gathered in relation to the following explanation: 'By 2020, most businesses will be required to use software on a digital device (e.g. smartphone, tablet or PC) to keep records of their business income and outgoings. And instead of sending one end of year tax return, most businesses will be required to submit a summary update of their business transactions from their digital device to HMRC every quarter.'

5 Attitudes towards tax compliance

This chapter looks at the attitudes of digital tech businesses towards tax compliance, including the reasons for compliance and non-compliance, as well as their perception on how widespread tax evasion is.

5.1 Tax compliance and businesses' priorities

Digital tech businesses reported feeling that compliance was important, but the priority they allocated towards it varied. The priority it was given depended on their ability to simultaneously manage their tax requirements and the day-to-day running of their business. Three broad perspectives emerged; the first of which was that **tax requirements were important, but the associated complexity meant there was greater scope for errors**. As covered in sections 4.3 and 4.4, these businesses tended to be those without previous business experience, support in-house, or who had deferred responsibility to their accountants.

Conversely, there were those who felt that **tax requirements and understanding business performance were interrelated and one could not be done without the other**. As discussed in section 4.2, this view was typically held by those who had reviewed their processes for managing their tax affairs (and brought in support, or moved to software), those with owners who had previous business experience, and those businesses who were more established. These businesses felt that investing in financial expertise in-house, or in software, aptly demonstrated the priority they placed on compliance.

Finally, there were those who felt that their **tax requirements were an additional element to manage and had the potential to take time away from their key concerns as a business**. This view was typically held by those who had not reviewed their tax processes and were primarily concerned with product development, sourcing funding, or reaching their market. In turn, these businesses were more likely to be **ground-breakers** who were offering an innovative product or service that operated in an entirely new market, or addressed a problem that previous had not been solved, who had to establish a market. These businesses used the precarious nature of their business to justify being unable to prioritise compliance.

"We were focused on 'let's get customers, let's make sure the tech's working'. We didn't even know if the business was going to make it another month, so managing tax affairs was not high on the list of priorities."

Small digital advertising and marketing business

"I would like to know that I'm paying the correct amount of tax so that I can sleep at night [but] I just can't spend one day a week scrutinising my finances to make sure it's correct. I just haven't got the time; it's a case of 'best efforts', really."

Small digital media and entertainment business

These businesses explained that, whilst compliance was not their main priority, they were reasonably confident about the accuracy of the information they provided to HMRC. Where businesses thought they may have made mistakes they considered these to be relatively minor (in their opinion). One business had heard, anecdotally, that HMRC did not pay attention until a business's turnover reached £1million. And in several cases, owners felt that while they might have made mistakes at this start-up stage, these would be too small or irrelevant to be followed up when it came to their tax returns.

"Frankly, the amount of money going through this business at this stage was so small and so irrelevant from the point of view of HMRC. They're not going to go and chase you...."

Small app and software development business

Born digital and transitioning businesses did not appear to behave differently in relation to compliance, or to have differing opinions. However, Fintech businesses consistently explained that their reporting requirements for the Financial Conduct Authority (FCA) took priority over their HMRC requirements. The Fintech businesses explained that this prioritisation was as a result of FCA regulation being far more stringent and the penalties more severe.

"If I'm losing a lot of customers' money, but I'm reporting it accurately, then for HMRC that's fine. But if I'm insolvent… HMRC would be unhappy, but the FCA would shut me down."

Mid-sized fintech business

5.1.1 The importance of paying tax

Businesses felt that paying tax was important, and had various reasons for doing so. On a macro-level, businesses understood that tax was needed to keep the country moving and to fund key services on which society depends.

"We all take for granted the NHS, the roads are fixed, the rubbish is cleared … You don't really realise that it is your tax paying for that, and if you don't pay tax then you won't have that."

Mid-sized fintech business

Additionally, for digital tech businesses with more of a social ethos, paying tax was more of a moral than a practical way for them to contribute to society. Businesses also felt a moral obligation to pay their taxes where they themselves had benefitted from the tax system – such as receiving tax reliefs.

"As someone who is deliberately taking a low-level salary to try and make something happen … I'm very thankful for anything from HMRC – R&D tax credits, SEIS and EIS – that makes it easier."

Small edtech business

For others, paying tax was not thought to be important in and of itself, but as a by-product of other priorities. Examples of this included:

- Thinking that being compliant and paying tax was a way to prove the sustainability and professionalism of the business to potential investors
- A way to avoid the hassle of fines and legal issues
- Understanding business performance and sustainability by having an accurate picture of the business's finances – through knowing what the business would pay in tax, and what they were eligible to claim back.

5.1.2 Tax avoidance and evasion in the digital sector

Businesses stressed that any mistakes they made, or might have made, were as a result of the perceived complexity of complying or ignorance, as opposed to tax avoidance or evasion. As discussed, digital tech businesses understood the importance of paying tax and had varied reasons for doing so. Participants felt they could not comment on the practices of the digital tech sector as a whole (as they typically did not discuss tax matters within their networks), but there was general acknowledgement that those in the early stages of developing their business could be more preoccupied with establishing their business than complying fully.

"When your head is in this, and you do work stupid long hours… like, some developers forget to invoice – there's that kind of mentality."

Small edtech business

Given that the digital tech businesses' interviewed stressed the importance of paying tax, intentional tax avoidance was universally condemned. On occasion, businesses spontaneously brought up the tax practices of global digital tech corporations operating in the UK, and in certain cases businesses were frustrated at their perceived preferential treatment. These businesses also felt it was unfair that, in their opinion, the sector as a whole was being tarred by the same brush. However, one business acknowledged that the issue was not clear cut, and the implications of such corporations relocating needed to be considered. This business pointed to the loss of National Insurance contributions and loss of jobs.

In reaction to the tax avoidance scenario[19], various reasons were given as to why businesses would avoid such schemes (where they were illegal). Those who had a longstanding business reputation to protect, an established customer base, or prospective investors or buyers were particularly concerned about the negative attention they would receive as a result of engaging in tax avoidance schemes. These businesses felt that engaging in such schemes would present too great a risk.

"You can't screw things up; you have to do things properly. At some point, there will be a due diligence process with an acquirer… you can't make any mistakes. There is no alternative."

Small digital media and entertainment business

Businesses who were primarily focused on attracting customers or product development also felt that it was not worth the time, effort, or complexity to engage in such practices. It was commonly recognised that to avoid tax, advice would be required from someone with in-depth knowledge of the tax system, and several businesses acknowledged that the cost of advice would probably mitigate any benefit they might receive from reduced taxes.

However, certain businesses pointed out that there was a notable difference between tax avoidance and evasion and whilst they condemned the latter, they appeared to be more knowledgeable about and supportive of, the former.

"Ultimately, if it's a scheme that reduces your tax liability, most people would be interested in it. It's about making sure it's legitimate and having that caveat – there's a fine difference between avoidance and evasion …you're all right to work within the rules, it's making sure you're not abusing the rules."

Mid-sized fintech business

Those who were more aware of, or open to, tax avoidance had someone in-house with financial expertise, who had specifically been brought into the business to look at structure, spending and tax from a strategic perspective. These businesses were also either mid-sized or, in one case, verging on mid-sized businesses – as discussed earlier, those who were smaller or less established either did not have the resources to pay for such advice, or the amount of tax they were paying was so minimal that advice on tax avoidance was not applicable to this stage of their business.

[19] Fictional scenarios were used to explore businesses' attitudes towards tax avoidance and evasion. The scenarios are included in Appendix C.

6 Conclusions

As an exploratory piece of research, this study has found that start-up digital tech businesses face many of the same growth and compliance challenges as other innovative non-digital businesses:

- They have challenges getting finance and investment, especially from traditional funding sources like banks.
- There is often a single founder or group of founders taking on multiple roles in terms of business development (e.g. building software platforms, or overseeing this), sales, financial management and recordkeeping. Within this, tax compliance can often become a lower priority in the initial growth stages.
- Retaining staff can be problematic, with examples of both small and mid-sized businesses needing to pay their staff below the market rate, and some resorting to share schemes to help with retention. Enterprise Management Incentives (EMI) were the most commonly mentioned share scheme and were seen as particularly important for rewarding and retaining employees.
- There is little interaction with HMRC, as most instances are handled by accountants or external agents (for example, submitting returns, or processing R&D Tax Relief claims). Accountants appear to have an important communications and guidance role, particularly amongst new businesses, and are relied upon to alert business owners to support available and to apply for reliefs on their behalf.

At the same time, there are some clear and important distinctions in how these businesses operate, compared to non-digital businesses. These will have implications for how HMRC communicates with them and how they go about their tax affairs:

- Not all digital tech businesses are run by technically-minded individuals, and there is a strong reliance on outsourcing and partnerships with other tech businesses.
- Accounting software fits well with how these businesses operate and there is an appetite for more interactions with HMRC to move online or to be automated (e.g. direct debit payments).
- The challenges faced by digital tech businesses are particularly acute for those doing something new (**ground-breakers**) as they have to prove they have a viable business to investors and attract customers, with little or no precedent and no price points they can use as benchmarks.
- There are strong local networks and hubs that smaller businesses in particular rely on for mentoring and sharing advice or guidance around new rules and schemes (e.g. the VAT MOSS scheme).
- Businesses face a lot of sunk costs upfront whilst they are developing their technology, and there are cases where growing a large customer base is the only way to get a sustainable and profitable business in the long run.
- Tax can get complex very quickly for these businesses, particularly those who have ambitions of expanding abroad and growing rapidly – before making a profit. As such, VAT is commonly the first complex tax issue they face, whereas CT is less of an issue – not because of its relative uncomplexity, but because it is not encountered, given the focus on growth of sales over profits in the initial stages of business.

Appendices

Appendix A: Technical details

Sampling and recruitment

Recruitment of digital tech businesses was primarily carried out by telephone using a sample compiled from several difference sources. Ipsos MORI also recruited developers through 'snowballing', whereby interview participants were asked if they knew other developers who would be willing to take part in an interview, and then asked to pass on their details to Ipsos MORI. Businesses were also recruited through LinkedIn.

Sample was primarily sourced through Beauhurst, a commercial database researching UK high-growth companies, and was also manually compiled through online searching for businesses' contact details. The full list of sample sources used in recruitment was as follows:

- Beauhurst
- Manchester Digital (https://www.manchesterdigital.com/)
- Sheffield Digital (https://sheffield.digital/)
- LinkedIn
- Participant recommendations (snowballing)

The recruiter was set quotas to ensure the final achieved sample had a good mix of digital tech businesses by the following criteria:

- Sector
- Size of business
- Growth stage
- Born digital or transitioning
- Region

Fieldwork

All fieldwork was undertaken by Ipsos MORI researchers and interviews lasted around 45 minutes. As a thank you, Ipsos MORI offered a cheque for £50 to all who took part, which was made out either to the interview participant or to a charity of their choosing.

The topic guide and associated stimulus materials were drafted by Ipsos MORI and approved by HMRC. A copy of the topic guide is included in Appendix B.

The following table shows the breakdown of the 50 achieved interviews:

Criteria		***Total***
Sector	E-commerce and marketplace	**10**
	Digital advertising and marketing	**9**
	Digital media and entertainment	**9**
	Fintech	**9**
	App, software and games development	**7**
	EdTech	**6**
Size of company	Sole trader	**2**
	Small businesses	**30**
	Mid-sized businesses	**18**
Growth	Start-up	**12**
	Scale-up	**16**
	Established and still growing	**20**
	Established and not growing	**2**
Born-digital vs. transitioning	Born Digital	**44**
	Transitioning	**6**
Region	Scotland	**2**
	Wales	**3**
	England	**45**
Approach	Tele-depth	**39**
	Face-to-face	**11**

Analysis

Interviews were summarised in a notes template, based on an analysis framework arranged by themes and subthemes. Throughout fieldwork, the fieldwork team and HMRC discussed interim findings and outlined areas to focus on in subsequent interviews. At the end of fieldwork, a final analysis meeting was held with HMRC, where key themes and headline findings were drawn out.

Appendix B: Topic guide

1: Welcome and introduction	Notes	Time
Thank participant for taking part Introduce self, Ipsos MORI – independent research organisation (i.e. we are separate from HMRC and have no details about their tax records) HMRC have asked us to talk to digital tech businesses/the digital arms of businesses about their growth ambitions, the kinds of barriers and challenges they face, and how tax comes into this No right or wrong answers All responses are totally confidential and anonymous – we combine your responses with those from other interviews How their answers will be used: their responses will be combined with other participants' experiences to feedback to HMRC. A report will be published on HMRC's website later in the year. Length of the interview around 45 minutes (and we will check with participant if they are happy to continue beyond this) Ask permission to digitally record – just to transcribe for quotes, no detailed attribution **Just to explain the structure of this interview, we'll briefly cover your business model, structure and history of the business in terms of growth, as well as looking at your growth ambitions for the future. However, we will need to move on to focus on your tax requirements and any support you turn to in managing your tax affairs. This is the main focus of the interview, so from time-to-time I may move the conversation on.**	Welcome, prepare for interview, outline the rules (under MRS Code of Conduct)	2–3 mins
2: Tracking the history of the business in terms of growth	**Notes**	**Time**
I'm interested in finding out a bit about your business – how it all began and how you grew to where you are today. **Firstly, could you briefly explain what your business does and your role within it?** How long have you been trading? ***Transitioning businesses only:*** How long has the digital arm of your business been operating for? How do you make money? Could you talk me through the ownership structure of the business? How long have you worked in this industry? ***If participant is not the owner of the business***: **How long has the owner of the business been operating in this sector?** **How do you pay your staff and yourself?** Is there a mix of salaries, shares and benefits? What made you choose this mix? *Interviewer refer to Appendix A: Growth timeline if necessary* ***Transitioning businesses only*****: I'd like to focus on the digital arm of your business for the rest of the interview.**	Make this section as brief as possible – the aim is to get a topline overview of the growth journey of the business from inception to present day. Use of timeline stimulus is optional, and should primarily be used as am aid to think chronologically.	5-10 mins

I'd now like to run through the history of your business – focusing on periods of growth or decline – from the very start up to the present day. **Thinking back to the very beginning, could you talk me through how the business was set-up and who was involved?** What funding, if any, was in place? How many members of staff? **Thinking chronologically now, could you mention any points where you have:** Received further funding or investment Take on more employees, or had to let staff go Had an increase or decrease in turnover Expanded or declined in any other way (e.g. expanded overseas) ***Transitioning businesses only:*** **When did you decide to grow the digital aspects of your business?** Was there a discussion or did it happen gradually? Who was involved in planning and making the transition? Is the digital arm growing? ***Transitioning businesses only:*** **How does the digital arm of your business fit in with the business as a whole?** Do you have different members of staff/senior management? Do you have the same budget/targets? What are the overlaps?		
3: Systems for managing tax requirements, attitudes towards HMRC and the UK tax regime, and awareness of tax related support	**Notes**	**Time**
Systems for managing tax requirements **I'd now like to move on and talk about the systems and processes you have in place for managing your tax requirements. This is to help HMRC understand if businesses like yours are different to more traditional businesses, and to see if there is anything in particular they could do to support you in the future.** **Could you talk me through the systems and processes you have for managing your tax affairs?** Who is responsible for doing this? (e.g. an agent, in-house bookkeeper) What software do you use? Which tasks are done externally (e.g. an agent) and which are done in-house? Storing and filing receipts and invoices Calculating tax payable Submitting returns Making payments How often do you keep track of your records/meet with your accountant? **How easy or difficult do you find dealing with your current systems and processes? Are there any particular aspects that you find difficult?** Time it takes to manage	In this section, it is important to get an overview of the system they have in place for managing their tax affairs, how they find this, and whether they have accessed any support relating to their obligations. Examples of tax reliefs include:	10-15 mins

Using difficult or complex software Understanding which records to keep hold of Understanding tax legislation Remembering to keep financial records **Does your business currently claim any tax reliefs and/or allowances which are designed for digital businesses? Have you done so up to now (if not covered earlier in interview)?** How long have you been using them? Why do you use them? What are the benefits or drawbacks? How did you find out about them, initially? **As your business has grown, have your tax-related systems changed? How?** Was there a point at which they brought in someone to handle the admin/tax? What did this 'tipping point' look like to them? Attitudes towards the UK tax regime and feeling supported within it **How well do you think the UK tax system supports your business to grow?** How well do you think HMRC understands your business model and needs? How well does it support your business to compete internationally? Are UK tech businesses treated fairly on tax compared to similar-sized international competitors trading in the UK? (Please think about reporting and recordkeeping requirements in your answer) Is there anything else that could be done to support your business's growth through the tax system? Is there anything that is causing your business difficulties? (e.g. restricting your ability to grow? **Have you sought any external support or advice in relation to growth?** Where did you look for/find information about how to grow your business? Have you engaged with other digital tech businesses in your local area, or a local Growth Hub for support? How easy or difficult was it to find the answers you needed? Have you sought advice from any of the following? Growth Hubs, accountants, Tech Networks, online forums, HMRC Do you have any specific suggestions about how HMRC can support the growth of businesses like yours? **If you have any questions or problems with your tax requirements, where do you go for support and advice (family, friends, agent, HMRC, online advice etc.)?** Have you ever experienced any specific difficulties or challenges in relation to meeting your tax requirements? What happened? If there was anything that could make it easier to meet your tax requirements, what would it be? **Have you had any experience of contacting HMRC for support in relation to your tax requirements?** Briefly cover what this was for, how they got in touch, whether the issue was resolved **Are you aware of HMRC's increasing focus on digital and online services?** Have you heard of the Business Tax Account?	Research and Development relief The Patent Box Reliefs for Creative Industries Disincorporation Relief Capital allowances Video Games Tax Relief Seed Enterprise Investment Scheme Enterprise Investment Scheme	

If aware: Do you believe that HMRC's increasing focus on digital and online services – such as the Business Tax Account (***Interviewer:*** Participants may also refer to this as 'Government Gateway') – will be beneficial? What difference would it make?		
4: Perceptions of tax avoidance and evasion	**Notes**	**Time**
This is the final section, and I'd just like to go into a bit more detail about your attitudes and opinions towards your business's tax obligations. **Generally speaking, how much confidence do you have in the financial record-keeping in your business?** Do you feel that your records meet tax requirements? Are there any particular aspects that you're not confident in? If you don't feel confident, what impact do you think this could have on your business? Have you thought about seeking advice or support to help manage this? **How would you describe your business's attitude towards complying with your tax obligations?** What kind of priority is this given? How difficult is it to manage alongside the day-to-day running of the business? If you were particularly busy, would keeping on top of your tax be a priority? How important is keeping up to date with your tax obligations, compared with other regulations that you have to contend with? In your own words, why do you think/why do you not think paying tax is important? Scenarios **I'd like to discuss some short scenarios. I will read out a few sentences *(or show cards if face-to-face)*, describing a made-up business; it would then be great to get your thoughts on it.** *Interviewer refer to Appendix B: Scenarios – please see my comments at the end of Appendix B* ***ASK AS AN ALTERNATIVE TO SCENARIOS, IF CLEAR SCENARIOS ARE NOT WORKING WELL, OR IF SHORT ON TIME* – focus on the culture of the industry** **Do you have a sense of attitudes to tax among digital tech businesses like yours generally?** How typical do you think your approach and opinions are compared to others? Do you think other businesses like yours might be involved in planning activities to mitigate the amount of tax they pay? How widespread do you think this might be? How do you feel about this kind of activity?	This section is quite sensitive as participants are asked directly about their opinion of tax avoidance/ evasion. It is important to handle this sensitively and to keep the conversation light. If participants become uncomfortable, the direct questions can be skipped in favour of the scenarios.	10-15 mins
5: Growth ambitions and perceived barriers to growth	**Notes**	**Time**
I'd now like to talk about your business's growth ambitions and any barriers you might face in terms of growth. *Transitioning businesses only*: Again, I am interested in the digital side of your business. **What are the main challenges you face right now around growth?** Capacity to grow the business/seeking investment/funding Hiring staff Skills to grow the business	It is important to determine whether leadership is a key driver of growth; whether businesses are	5–10 mins

Consumer/market demand **Could you talk me through your future plans for growth?** ***If not established earlier***: do you have a business plan outlining your growth expectations? Where do you want to be next year? In the next 5 years? 10 years? Do you have any plans to expand internationally? Based on the challenges you mentioned, how realistic do you think your plans for growth are?	accessing any support on how they can grow; and what the barriers that they face are.	
6: Conclusions	**Notes**	**Time**
Anything else about your business's approach to growth or tax requirements that we haven't had a chance to discuss? Explain the next steps – anonymised report will be published by HMRC on the GOV.UK website when the research is complete Mention £50 donation to the participant or charity of their choice (likely collected details during recruitment but double-check) **SNOWBALLING**: **Are you aware of/in contact with any other UK digital tech businesses like yours that could take part in this research?** We especially want to find transitioning businesses that do both digital and non-digital work, and where the digital part is growing. Do you know of any such organisations? Would you be happy to pass on any contact details you have for these businesses, so that we can get in touch and invite them to take part? *If participant has agreed at recruitment to have photos taken of their record-keeping processes, then ask their permission again and show them the data security form. Please take up to 5 photos.*		2–3 mins

Appendix C: Scenarios

The following scenarios have been tailored according to the size of the business:

- **Sole-traders** and **micro-businesses**: scenarios based on the hidden economy[20] and evasion
- **Small** and **mid-sized businesses**: scenarios based on evasion and avoidance[21]

Small businesses	
Mr X is a freelance, self-employed app & software developer. He has been in business for a number of years and knew that he ought to register for self-assessment but he never has. Mr X's business has grown and he knows that he should be registered for VAT too. HMRC identified Mr X's business activity through third party data – he had been accepting card payments. Mr X is currently not paying tax and may be liable for a penalty or other sanction if this is investigated.	*Company A is a small publishing company whose business model has moved increasingly online in recent years. Some publications are still print-based but some are now entirely online publications – and revenue is generated through subscriptions. Although the company has been paying tax on income generated from print-based sales, the revenue generated from the online versions has not been declared for tax. Therefore, the business is not currently paying as much tax as it should be.*
Why do you think Mr. X might not have registered for Self-Assessment and VAT, to declare his income with HMRC? How widespread do you think this behaviour might be in this sector? Have you ever heard of anyone doing something like this?	Why do you think the company might not have declared their online sales to HMRC? How widespread do you think this behaviour might be in this sector? Have you ever heard of anyone doing something like this?
Medium businesses	
Company B is a retailer whose business model has moved increasingly online in recent years. The majority of sales still take place on the shop floor – but customers can now also purchase goods via the company's website. Although tax is paid on income generated from sales made at their retail premises, the company are not yet paying tax on income from sales made on the website.	*Company C has been trading as a web design business for five years and are now expanding their operations due to increasing demand. They speak to a financial adviser about how they might take on more staff and what the best way to structure their business might be. The financial adviser outlines a number of options – and one of these involves participating in a scheme which has been set up with the sole purpose of reducing the amount of tax the company is required to pay.*
Why do you think the company are not paying tax on income from sales made on the website? How widespread do you think this behaviour might be in this sector? Have you ever heard of anyone doing something like this?	How likely do you think it is that the company would opt to take part in the scheme? Have you ever heard of anyone doing something like this?

[20] The hidden economy consists of those who fail to register for tax, and those who fail to declare a source of income.

[21] Tax avoidance involves legally exploiting the tax system to reduce current or future tax liabilities, whereas tax evasion is to escape paying taxes, illegally.

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