



# Social Norms and Networking

## Research into the tax compliance of the self employed

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**Prepared by:**

Quadrangle Group LLP  
Quadrangle  
The Butlers Wharf Building  
36 Shad Thames  
London SE1 2YE  
t: +44 (0)20 7357 9919  
f: +44 (0)20 7357 9773  
w: [www.quadrangle.com](http://www.quadrangle.com)

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## 1.0 Executive summary

### 1.1 Background

This research evolved following internal review within HMRC which identified a need to explore tax compliance and networking behaviour of the self-employed. The aim of this project was to gather information which would develop a better understanding of social norms and networking behaviour of certain groups of self employed taxpayers. The project was qualitative and exploratory in nature and involved in-depth interviews with 40 taxpayers, all Sole Trader businesses.

Research participants from two trades/ professions were selected – IT web professionals and building and affiliated trades such as electricians. Participants were selected on the basis of fitting into two sectors defined in the HMRC SME Customer Segmentation<sup>1</sup>; Rule Breakers and Potential Rule Breakers. Rule Breakers are actively non compliant whereas Potential Rule Breakers show traits indicating they would like to be non compliant but generally pay tax that is owed.

### 1.2 Findings

#### 1.2.1 Networks

- The research clearly demonstrated that self-employed networks exist in a variety of shapes and sizes. Their diversity impacts on the extent to which networks influence an individual's attitudes and potential behaviour and there are formal and informal, personal and business oriented networks. These are inter-related, dynamic and largely not focussed on tax.
- When engaging this audience it becomes clear that networks have the potential to normalise cheating behaviours, and the level of cheating will often be influenced by the behaviours in the network itself. When it comes to the propagation of non-compliance messages within networks it is often the trust and openness amongst members that dictate;
  - a.The speed with which a message is channelled;
  - b.The level of sensitivity attached to it (i.e. the extent to which it pushes the compliance boundaries).
- According to those interviewed the networks of IT professionals and trade workers are often different. Trade networks usually take place face to face and are more spontaneous and social in nature. Consequently the levels of emotional involvement and trust tend to be quite high. On discussion it becomes clear that this affects the type

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<sup>1</sup> SME Usage and Attitudes – SME Customer Segmentation, Research Report No. 205 (HMRC, 2012)

of compliance messages propagated within the group as individuals are more inclined to discuss their thoughts and attitudes towards rule breaking.

- This research implies the involvement of trade workers in more organised business networks is smaller than that of IT professionals. Interviewees suggest the network 'web' of IT professionals is typically wider, more organised and more strategically focused. However, whilst social networks are often smaller for IT professionals, and occur less frequently, they are just as important when it come sharing more intimate thoughts and messages.
- It is clear from the outputs that there is limited understanding of the mechanics of the tax system, how it works or is administered or what its priorities are (beyond simply collecting tax) for the vast majority of Sole Traders. For most, this research shows, tax is an inconvenient necessity rather than a business priority.
- The research shows that individuals' tax awareness and understanding can be directly influenced by networks and that messages that gain traction within a network tend to become assumed wisdom.
- Based on these findings it becomes clear that the Agent (e.g. accountant or book-keeper) is the most significant source of information when it comes to issues of tax compliance. Even for those without an agent as many messages around tax – formal or informal – do start from information gained from 'experts'. It is significant that advice from 'experts' is treated as significant by Sole traders as they are perceived as trusted individuals with high levels of knowledge and expertise.

### 1.2.2 HMRC messaging

- This research has clearly shown that HMRC's formal messaging about tax compliance is not widely acknowledged or remembered by the Sole Trader community. For those interviewed, the types of communications received are felt to focus on the wants of HMRC rather than what might be beneficial or valuable for a Sole Trader trying to run their business. Consequently, as they are perceived to lack much tangible relevance, messages tend not to gain much traction.
- Most Sole Traders, according to this study, are aware that penalties exist for non-compliant behaviour. However they are, on the whole, relatively disinterested in the details of the associated penalties. As a result, the relevance and cut-through of related media messages is diluted and largely ignored.

### 1.2.3 Social norms

- Sole Traders involved in this project, on the whole, feel hard done by and the general consensus is that government are doing very little to help their plight which has been worsened by the current economic climate and the business challenges this has created. This research substantiates a point of view already widely acknowledged that small business sees itself as the backbone of the UK economy without the might of the large corporates and as such is 'put upon' by Government.

- The research also highlights the fact that all Sole Traders consider tax efficiency to be good business practice and they will actively seek out, and be receptive to, ways to legally minimise their tax liabilities. For most, paying less tax is an acceptable part of being self-employed.
- Most Sole Traders interviewed believed their evasion is 'low level', and thus unimportant in the wider scheme of tax not paid (i.e. versus large corporate business). For those entering into low level evasion the belief is they will evade detection – this thought is driven by a further belief that they are not the primary focus of HMRC detection activity.
- Whilst Potential Rule Breakers are traditionally more likely to shy away from illicit 'action', Rule Breakers are more likely to embrace it. However, in the case of 'my money' jobs (i.e. cash in hand, weekend work for friends etc.) the level of perceived – and actual – risk is minimal; hence a more generic belief pervades both audiences, and more consistent behaviour emerges.
- For many small businesses in this research the thought of being VAT registered is not a desirable prospect. The research has shown that it can reduce a business' competitiveness (in the context of a burgeoning and cheaper competitive set). For some interviewed this has led to attempts to actively avoid becoming registered via the non-disclosure of income. In light of this research, we can assume this situation has the potential to grow, driven on by the affects of a weakening economy.

#### 1.2.4 Weakening economy

- Across the sample there is a feeling of broad apprehension as to what the future holds for UK small business in an uncertain economic climate and the research has detected an increasing willingness – by some but not all – to take more risks to guarantee a certain level of personally acceptable income.
- Based on these findings it is clear that financial pressures – driven by the current economic situation – and an overall sense of injustice is having a direct impact on the behaviour of some Sole Traders. They are using it as a justification to, on occasion, not declare earnings, but this is a tendency aligned with specific attitudinal leanings – explored in fuller detail within the body of the report.

### 1.3 Conclusion

The research conducted has clearly demonstrated that networks play a key role in the propagation of information about effectively managing the finances of a small business. The messages that gain traction are those which offer a tangible business benefit to the Sole Trader, which compliance messaging from HMRC rarely does.

The majority of participants interviewed showed a generalised norm to low level evasion. Low level evasion is acceptable and seen as unimportant within the whole picture of tax collection (compared with large corporations). There was evidence to suggest low level evasion will become more prevalent as Sole Traders feel pressures within the weakening economy.



## 2.0 Background and methodology

### 2.1 Research objectives

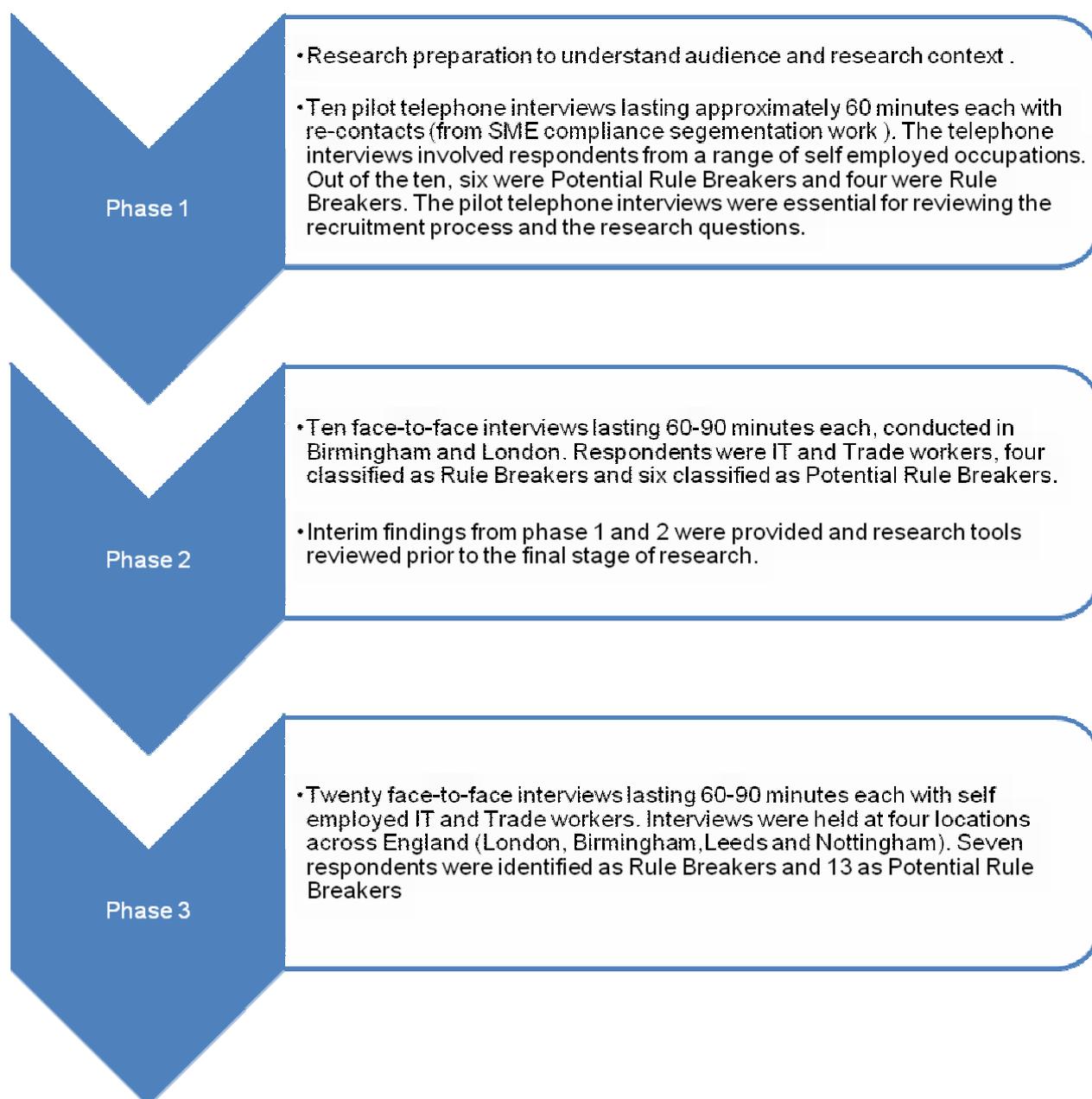
This piece of qualitative research was commissioned by HMRC to explore tax compliance and networking behaviour of the self-employed.

The four core objectives encompass the key areas in which the research focused, these were to:

- 1. Understand the nature and shape of taxpayer networks**
  - What are the personal and business networks in operation?
  - What is the process of how these networks are created?
  - How they are maintained and how do they evolve?
  
- 2. Understand the influence of HMRC activity on networks and how aware the self-employed are of HMRC messages**
  - What is the level of awareness around specific messages from HMRC about tax (including tax deterrents, penalties and audits)?
  - What type of messages are shared and why?
  - How are messages communicated within and across networks?
  
- 3. Collect information on social norms in relation to general attitudes to tax of the self-employed related to views around:**
  - 1. Government provided services**
  - 2. Paying tax**
  - What are individual perceptions of tax compliance?
  - What are the distinct social norms in this group?
  - How do they exist and how are they influenced?
  
- 4. Explore tax compliance in a weakening economy**
  - How have the current changes in the economy impacted on business?
  - To what extent has behaviour changed within the network in recent months in relation to a weakening economy and the affect on tax compliance?

## 2.2 Research methodology

In order to provide a deep level of insight into Potential Rule Breakers' and Rule Breakers' attitudes and behaviours, and what drives these, a three staged research approach was used.



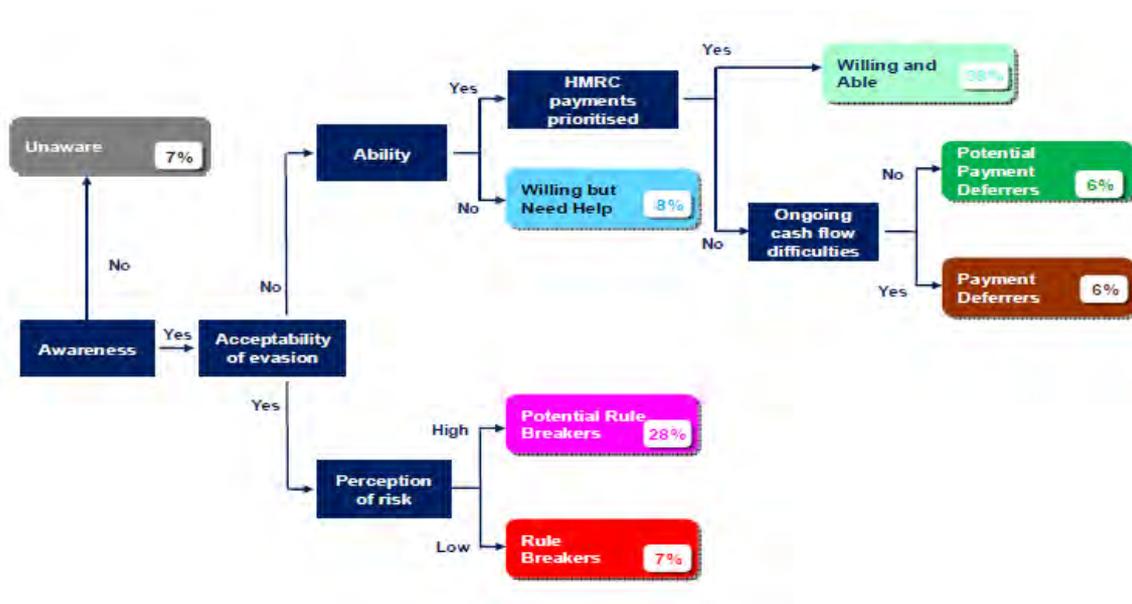
### 3.0 Overview of existing learning

#### 3.1 SME Customer Segmentation – an overview

The SME Customer Segmentation was developed by HMRC and Quadrangle LLP in 2009. The work was based on a sample of 1468 interviews with UK SMEs, conducted in January and February 2009. The segmentation was built on six core dimensions:

- Awareness
- Motivation (to comply)/ ‘attitudinal compliance’
- Perception of risk
- Ability
- Pragmatism/ ‘situational compliance’
- Financial difficulties

These six dimensions deliver a seven segment solution, an outline of which is detailed below.



This research is targeted at two specific segments – Rule Breakers and Potential Rule Breakers – and for context we provide a basic summary of their attitudinal profiles.

### 3.1.1 Potential Rule Breakers

Potential Rule Breakers are the second largest segment (Willing & Able are the largest), accounting for 28% of the SME universe. Although they seek to reduce their liabilities by any 'legal' means, fear of being caught and punished makes this segment less likely to evade.

Potential Rule Breakers are aware of their tax obligations, but not necessarily confident in their awareness of all the details. As such they rely on like minded agents to enhance their familiarity with tax and help them limit their liabilities, showing a willingness to push boundaries wherever possible.

They have very little trust for HMRC, so tend to adopt an adversarial approach to their dealings with the organisation. They don't want to draw attention to the business, so they often prefer to use their Agent to advise them on the system, rather than go direct to HMRC.

Potential Rule Breakers will look to exploit any areas where they perceive a greater degree of flexibility (e.g. restructuring payment schedules), and have a propensity to pay late, seeing payment of taxes as less of a priority than paying staff or suppliers. Cash-flow issues may be another reason to start looking to actively limit tax liabilities.

Members of this segment would like HMRC to show greater empathy towards the difficulties of securing payment from creditors. Although cash-flow might be tight, avoidance behaviours are ultimately driven by a focus on not paying more than you have to.

### 3.1.2 Rule Breakers

Rule Breakers account for 7% of the SME population. Entrepreneurial, they tend to be inherent risk takers who are comfortable breaking the rules. Although highly aware of their tax obligations, they show low levels of motivation to consistently comply. As such, Rule Breakers not only accept tax evasion, they actively practice it.

They believe that cheating is actually quite commonplace, and that true evasion is complete non-payment, whereas partial disclosures are quite normal; something that everyone does to get the best deal for their business. In fact, the segmentation research indicated that small-scale evasion is actually seen as good business practice and a demonstration of commercial savvy.

Being of the belief that they know the limitations of what the system is able to achieve, Rule Breakers have a low perception of the risks of cheating. They think of HMRC as an under-resourced 'Big Brother', always looking to catch them out but not able to look everywhere all the time.

Although they are overtly distrustful of HMRC and seek to keep the relationship on their own terms, they don't avoid contact; Rule Breakers have the highest contact rate of all segments. They tend to be resentful, believing that SME's are an 'easy target' for HMRC, lacking the financial clout of larger corporates who can rely on expensive expert advice and legal protection.

Confident and able, they make sure they keep on top of what they are doing so that if questions are asked they have an answer. They also have the highest levels of Agent usage of all seven segments. Managing their finances and 'working the system' is central to their ability to stay 'below the radar'.

Payment of staff and suppliers will be prioritised over HMRC payments, with late payment seen as an operational cost of business and not of concern. Cash is king for Rule Breakers, so when it's tight the temptation is to take more risks.

## 4.0 Glossary of terms

- 4.1 **Messages** – Pieces of information that generate enough relevance and traction to be spread via word of mouth from person to person or person to people. The delivery channel for the information can be:
- Formal and more direct (i.e. it is received either from HMRC itself (e.g. broadcast advertising) or via an agent (e.g. the agent filters direct information from HMRC before giving it to the client);
  - Informal and indirect i.e. it is received from a peer or like-minded individual and does not necessarily stem directly from HMRC (e.g. information that is picked up by an individual in one network and subsequently passed on to their other networks).
- 4.2 **HMRC messages** – Communication that comes directly from HMRC in the form of broadcast advertising, Direct Mail, email.
- 4.3 **Word of mouth** – The verbal transfer of information, or a spoken message – e.g. via a face-to-face or telephone conversation.
- 4.4 **Sole Trader** – A business which is owned by one person who is fully liable for the company's debts and fulfilment of contracts with his / her personal wealth unless incorporated. The owner is the business and therefore, unlike with a Limited Company, there is no limited liability. The owner is liable personally for all debts of the business.
- 4.5 **IFA (independent financial advisor)** – A person qualified to give financial advice to clients on life insurance, pensions, funds, and other financial products, who is not tied to any one financial institution. They may charge their clients a fee for their advice or may receive a commission on the products which the client buys. An IFA's recommendations are based on which company and products best suit the needs of the client (Canada Life, Glossary of Terms, 2010).
- 4.6 **Agent** – A financial intermediary, such as an accountant or book keeper that does work on behalf of the individual.
- 4.7 **Tax efficiency** – The legal organisation of financial affairs to minimise tax liabilities.
- 4.8 **Tax avoidance** – The legal manipulation of tax regulations to reduce tax obligations.
- 4.9 **Tax evasion** – The failure to pay tax on a proportion or all of income earned.

## 5 Findings from the qualitative research

***The following content is based purely on the findings from this research. Where findings have been complemented by work outside of this study we have clearly referenced the source.***

### 5.1. Understanding the nature and shape of tax payer networks

#### Overview

- Networks, by their nature, are not static. Instead they are in a constant state of flux and evolution and the diversity of networks makes it extremely difficult to simplify or generalise in order to define them or their influence.
- Networks play a key role in the propagation of information about effectively managing the finances of a small business. This includes tax, and usually refers to how to minimise liabilities and get the 'best deal' for the small business.
- Self-employed networks exist in a variety of shapes and sizes. This level of diversity impacts on the extent to which networks influence an individual's attitudes and potential behaviour.
- The research shows three types of network exist – 'business', 'circumstantial' and 'personal' networks.
- The likelihood of messages relating to cheating being transferred within networks is driven by the level of trust and openness shared between members.
- Networks can normalise cheating behaviour, and the level of cheating might depend on the behaviours within the network.
- There are no salient differences between the networks of Rule Breakers and Potential Rule Breakers. However, key differences emerge between IT and Trade networks in terms of how they are formed and how they function.
- A business network can act as a deterrent to cheat due to the overarching desire of those involved to maintain positive professional reputations.

Self-employed Sole Trader networks – the subject of this research – are continually developing and changing shape. Consequently, attempting to create 'one size fits all' descriptions is both challenging and in part misleading. Of more value will be developing an understanding of how and why networks develop, and establishing better clarity in terms of the network journey tax payers go through, and the different stages on this journey. It is through this approach we will seek to understand how networks can play a key role in understanding compliance behaviours.

Information gathered within the network environment is influential when it comes to driving decision making. Networks are trusted and valuable sources of information and as such can influence behaviour and behavioural change.

### 5.1.1 Differences between Rule Breakers and Potential Rule Breakers

There do not appear to be any significant differences in the networking *behaviour* of Rule Breakers and Potential Rule Breakers. Who their networks are, when they engage them, and why, stays fairly consistent across the sample. Of more significance, when it comes to issues of compliance, are the differences driven by the actual propensity to evade, the information in the network and what is acted upon.

When considering the differences between the two segments it is important to note the role of the opportunity. Evidence generated in the SME Customer Segmentation is further supported by the output of this study, and the network dynamic provides a lens through which these differences can be viewed:

- Rule Breakers consistently cheat, and are constantly *seeking out* opportunities to do so. This is what defines them as individuals. They represent an **active** threat to levels of compliance and thrive on information which they believe helps them successfully cheat the system. This type of information can be generated within networks.
- Potential Rule Breakers mostly comply but very occasionally break the rules, should a 'risk free' opportunity present itself. They represent a **passive** threat to compliance.
- The research indicates that the transition of Potential Rule Breakers from **passive** to **active** engagers in non-compliance behaviour has the potential to be influenced by networks as they are exposed to different ways of working round the system, albeit in a way that remains within their comfort zone.
- The major shift the network is able to influence is in the Potential Rule Breakers perception of risk. The network can, over time, make evading seem 'less risky' as individuals learn what they might get away with and how they can 'stay off the radar'.

### 5.1.2 Different types of network and what they look like

Self-employed networks exist in a variety of shapes and sizes and there are various factors impacting on the extent to which they influence an individual's attitudes and, potentially, behaviours.

The research found that that make-up of networks differs on a number of levels:

- Whether they are more social or business orientated in nature.
- Their level of sophistication and the extent to which they are formal vs. informal in nature.
- The growth ambitions of a company / individual (for example, those looking to expand and employ others might require a bigger network to facilitate making that step, whilst those who are nearing retirement will require a less progressive network).
- The scale / scope / type of work being undertaken by an individual ( there are some differences between sample groups – to be explored in detail later).
- Size (number of actual people).

- Regularity of contact.
- Whether they exist physically or virtually.
- Geographic catchment.
- The types of information / messages that pass through them.
- The level of transparency and trust in the network.
- Where contact takes place.

The research shows that trust and credibility are key ingredients when it comes to establishing the level of openness afforded to a network. This is particularly relevant when it comes to discussing issues of compliance as natural barriers are put in place when conversations occur with people who are less well known by the individual. Only when high levels of trust exist is tax compliance likely to become part of the natural discourse.

*“When I meet up with my mates it’s one of the things we talk about. We’re all in the same business really so what works for one of us is going to be interesting for everyone else. You’re not going to tell a total stranger – ‘oh yeah, I’ve been dodging taxes by doing this or doing that’. With your mates it’s different, it’s just a bit of a game really.”*  
(IT worker)

This research indicates there is a distinction between formal business networks (e.g. breakfast mornings) which tend to be more ‘advisory’, and less formal personal networks (e.g. social peer group) where people may be more likely to discuss non-compliance. In these contexts trust very much influences what a network looks like and how it operates:

- Formal (business) networks seem to drive knowledge and transmit information. Whilst messages initiated in formal networks may flow into more informal personal networks, this flow of information appears less likely to take place the other way round.
- Information shared within the network appears to be dependent on degrees of trust; greater levels of trust are associated with openness about taxation and (non) compliance (reflecting patterns of reciprocal self disclosure, as seen in the formation of interpersonal relationships).

The make-up of a network, i.e. who exists in it, is very much dependent on the circumstances that hold it together (i.e. whether it is business, social or recreational in nature). However, as the research illustrates all networks are united by at least one common denominator that ties all members together – e.g. a sports club held together by an interest in football, a friendship group supporting a network of peer to peer relationships and more distant ‘friends of friends’, connected via a core group of individuals, or a morning breakfast club supporting a network of individuals from very different backgrounds (from professional services to tradesmen), all possessing a common interest in forming mutually beneficial relationships that will help drive the growth of their businesses.

### 5.1.3 Trade differences

Throughout the research it became apparent that there are no discernable differences between the networks of Rule Breakers and Potential Rule Breakers. However, the research does illustrate that there are some key differences when it comes to the networks of IT and Trade workers and how they function:

- Trade Networks usually take place physically (face to face) and often socially (e.g. over a drink in the pub), and are mainly local or regional. Only on rare occasions do they appear to become national. Networks in this context tend to consist of other trade workers, since the professional and accounting demands on them are seen to be very different to other professions (due to the 'outlay' for materials, mileage, vans etc.).

*"After work I'll often go for a drink with my son and I'll meet my mates in the pub. You just get chatting about stuff don't you? Most of the time it will be about the footy, or just a load of nonsense. Sometimes we'll talk about financial stuff and that. Some are more into it than others."* (Trade worker)

*"A lot of the parents from my son's school are from similar backgrounds and work in the industry so I do a lot of work for them. Dads at school have also taken up a bit of football and one of the dads has got a large company portfolio and does a lot of refurbishments and installations. It's a great network. We've got a Corgi registered plumber that does a lot of the gas work, an electrician, etc."* (Trade worker)

- IT Networks are both physical and virtual. Many have business relationships based around social networking sites such as Facebook or LinkedIn, this naturally gives the networks both national and international scope. This can lead to information sharing purely motivated by a desire to share experiences rather than for specific reward or a desire to influence. The use of the internet to drive network behaviour is natural for this audience due to the fact that it represents the platform on which they carry out their work, and hence spend much of their time. They are also both confident and competent when it comes to using the internet which sees them actively seek out and explore alternative online groups.

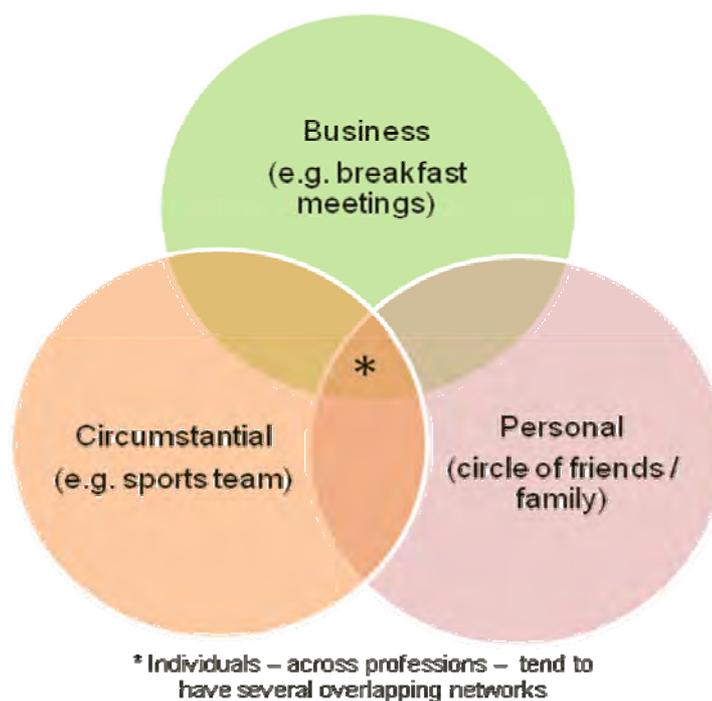
*"I go on LinkedIn and there are a couple of others. You can build up your network and get linked into other people they know. It's a way of getting in contact with a company you want to work with. It's useful to get to the right person."* (IT worker)

- Employees working in the IT space are typically more educated, increasing the geographical spread of the network, which also tends to include self employed people from variety of different industries. The level of education is a key differentiator in these networks as it often works as a proxy for a different set of 'personal norms' which are an important mediating lens in the development of social norms.

In summary, whilst the crossover of business and social networks happens for both, the networks of IT professionals and trade workers are often different. Trade networks usually take place face to face and are more spontaneous and social in nature. Consequently the levels of emotional involvement and trust tend to be quite high. This affects the type of compliance messages propagated within the group as individuals are more inclined to discuss their thoughts and attitudes towards rule breaking. This study suggests the involvement of trade workers in more organised business networks is considerably smaller than that of IT professionals (and other 'white collar' professions). When involvement is apparent it is often driven by more commercially successful Sole Traders or ambitious individuals seeking to develop their businesses quickly and efficiently. The network 'web' of IT professionals is typically wider, more organised and more strategically focused than that of trade workers. However, whilst social networks are often smaller for IT professionals, and occur less frequently, they are just as important when it come sharing more intimate thoughts and messages.

#### 5.1.4 Breakdown of different networks

Illustration 5.1.4 (a):The type and overlap of networks



The findings in this research clearly show that three main types of network exist:

1. **Business networks** (e.g. face to face breakfast meetings, online forums)
2. **Circumstantial networks** (e.g. sports clubs, community involvement, parents)
3. **Personal networks** (e.g. circle of close friends, family)

(See appendix 3 for more detail on the networks).

### 5.1.5 How networks are formed and evolve

Networks are formed and exist 'organically', they are 'dynamic', and they are in a permanent state of evolution as people move within and through them. Consequently, any description of a network reflects a 'point in time' only as it is likely to shift in size and constitution over time. Whilst it is possible to purposely start a network (such as an organised breakfast morning), feedback from the research suggests that most of the time it will still start off as an existing group of known acquaintances and grow from there. From the interviews we can infer that the scale of this growth will be determined by the primary purpose of its creation – i.e. as a result of circumstance (e.g. sports club, anti-natal) vs. to provide business advice. In reality, for most of the self-employed in this study, new networks start their existence as a 'branch off' from an established network, forming and building as contacts develop over time.

Whilst networks can grow quite rapidly, when busy, Sole Traders will often become less active within them. For Sole Traders 'time' is everything and spending time on activities outside of the core business decreases the earning potential. A core benefit of networks – whether business or social – is that they allow the individual to disengage for short periods of time without damaging relationships or the overall group dynamic.

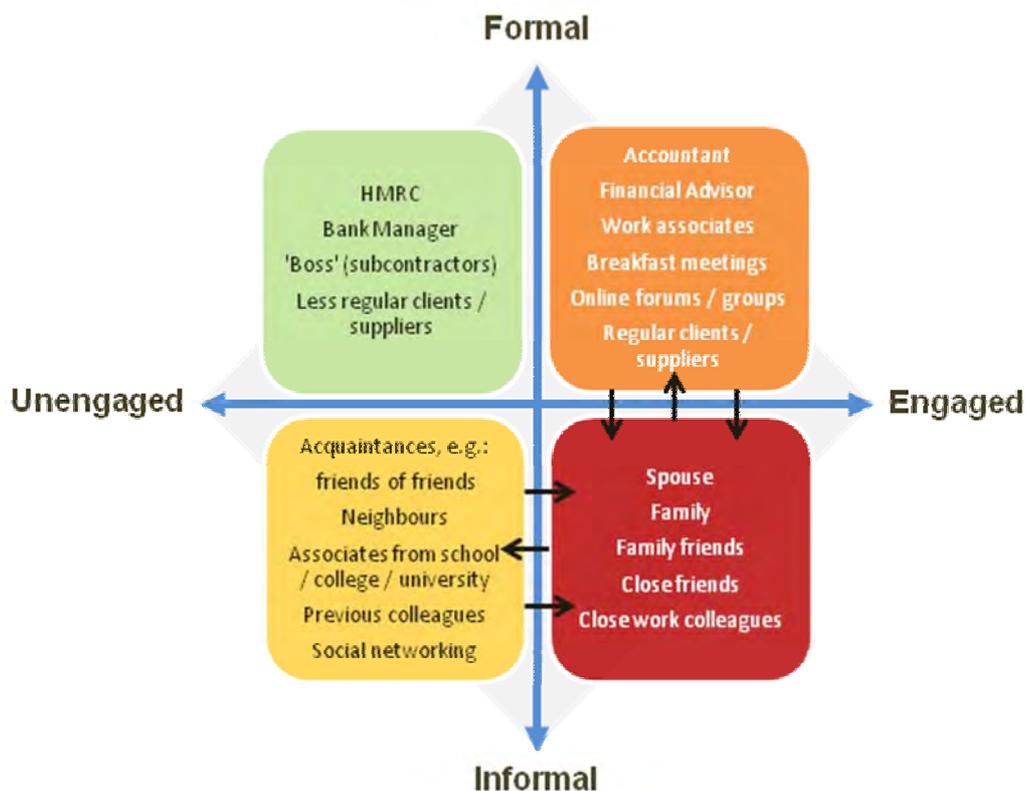
Changes in a network are typically driven by the people within them – when new people join, with different insights and ideas (e.g. in relation to off-setting tax liability), different competencies and levels of understanding in terms of building, maintaining and optimising business development and strategy. Individuals cross networks, and most people can exist in different networks simultaneously.

The influence of a network is not necessarily dictated by how sophisticated it is. Whilst the research shows more sophisticated networks will contain individuals with advanced business skills and acumen (e.g. lawyers, accountants, bankers) this does not mean it will have more of an influence on behaviour than that of a purely social based network. Again, it is the relationship between the emotional closeness and trust levels of a group, and a person's propensity to 'break rules, that will have the greater influence on actual behaviour.

Those who work within a trade are more likely to have gone straight into work from school, with a lower level of education which often limits the scale of their network to people of a similar background. This network is likely to be smaller and more closed. For these people site work is integral to the formation and evolution of networks, as a means of meeting and maintaining contact with associates. IT workers tend to be more educated, with a greater awareness of suppliers. Consequently they have more contacts and they tend to have a broader reach within the network.

We have seen that networks have a definite impact on the attitudes of individuals. Attitudes will often reflect those of the individual, either because the shared group attitude drives the cohesion of the network, or because individuals within the network modify their attitudes to strengthen their membership within the group. Group norms are informed by networks and the changes within them.

Illustration 5.1.4 (b) Different types of network and who is in them



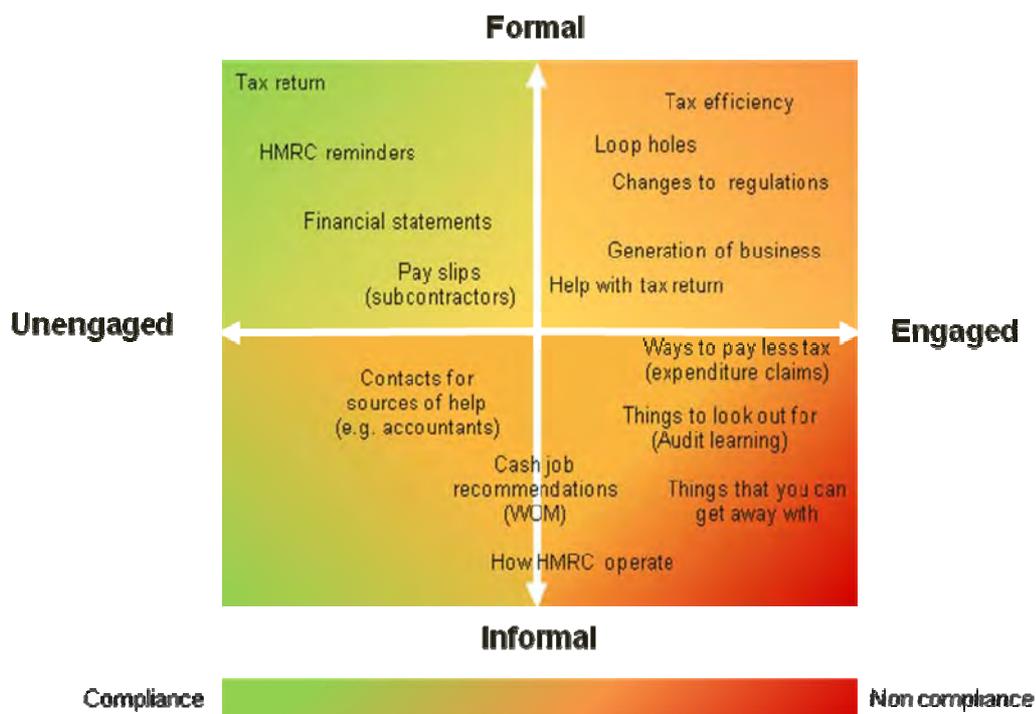
### 5.1.6 Sustaining networks

The research suggests networks are maintained via a number of factors:

- Regularity of contact** – the level of contact required will be dependent on whether the network is business or social in nature. Personal networks tend to be characterised by more frequent, less formal contact, and involve people who share a closer emotional bond. This contact is typically incorporated into the weekly lifestyles of individuals, and hence can be both spontaneous and planned. Whilst business 'chat' will often form part of the conversation, for the most part it will be a small part of a much broader, lifestyle based, discussion. Business networks will occur less frequently – approximately every four weeks – and are very much planned in advance; both in terms of when and where. However, business networks often spawn smaller groups of people who develop close friendships, and these people will meet more often, in less formal situations e.g. to play golf. In addition, online business networks, due to the fact that they avoid the practical issues associated with face to face meetings (e.g. lack of time, travelling, cost) happen more frequently, and more spontaneously. The ability to connect is instantaneous.

- **Word of mouth** – the proliferation of messages is key to the growth of a network.  
Networks generate a continual churn of information that works to attract new members. As network numbers increase so too does the ability of the network to acquire new people as increasing numbers are made aware of its existence. Consequently the depth and variety of information within the network grows, and this then gets disseminated in a virtual cycle of communication.
- **Quality of information** – social networks possess longevity due to the fact they are primarily driven by interests outside of the business context. Shared interests and histories create a bond that ensures they perpetually exist. However, to remain relevant, networks with a greater emphasis on business issues require the information that passes through them to be significant and beneficial to the individual members. Once a network becomes surplus to requirements it will be ignored. If this happens at a broad level its very existence will come under threat. Consequently, the research suggests business networks are more transient by their nature, and tend to have higher levels of churn.
- **Vibrancy of the network** – networks have more chance of surviving and thriving if it possesses characters that not only add value at a business level, but also make it interesting on an emotional level. It is when a network achieves this that it starts to generate additional smaller cliques, with individuals connecting on a personal level and becoming friends socially. Most Sole Traders who are part of business networks admit they remain engaged in the group as much for the interesting people they know and meet as they do for business advice etc.
- **Rational and emotional drivers** – people interact with different networks in different ways. Central to this is the extent to which the sense of group belonging is driven by an emotional connection (e.g. old friends, share common interests) or a functional one (e.g. gain new business opportunities, commercial value). Emotional drivers are more entrenched, will be longer lasting and typically draw on shared experiences and a sense of fun. Rational drivers can be very short term and are often self-centred – ‘it’s about what’s best for the business’. Whilst networks exist at both ends of the spectrum – rational (business network) versus emotional (social network) – there will often be an over-lapping of the two as what starts out as a business connection turns into more of a social relationship. A new network is thus created.

Illustration 5.1.4 (c): Type of information shared in different networks



### 5.1.7 The role of the individual

Each network is made up of different types of individual and, depending on what type of individual you are, your role within the group will differ. Members tend to split into two groups – ‘transmitters’ of information, or ‘receivers’ of information. The role played appears to be determined by three key factors:

- **Personality type** – extraverts are more likely to transmit whilst introverts are more likely to receive information. However, personality is not enough in itself. Information must also possess substance for both the insight and individual to be received as credible.
- **Status** – established and more respected members of a network will tend to transmit more messages than those with less credibility within the group. Status must be earned, and stems from delivering relevant information on a consistent basis.
- **Knowledge base and skills** – accountants and other professional services are more likely to transmit information regarding finance and taxation. They are recognised as both important and influential members of the network.

*“Accountants use these groups (business networks) all the time, even reasonably sized accountants. They are very influential people, and bring a lot of value to the table in terms of business know-how.” (IT worker)*

However the role of the individual can change depending on the type of network they find themselves in at a given time. The research has shown that whilst many plumbers, for example, might be the receiver of a tax message in a formal business network, they then become the transmitter of that information when meeting up with other plumbers / trades people in a social setting. Within this context different roles are established by the relative status afforded to the individual, their overall personality and the extent to which they are known.

### 5.1.8 Impact of network on compliance

Networks definitely play a role in the forming of attitudes and behaviour around tax compliance. Whilst some networks are more organised and business focused than others, they all provide an open platform for discussions about finance (both personal and business), taxation and opportunities to save money. Networks provide the individual with emotional support, and can work to justify modes of thinking. This has the potential to reduce levels of cautiousness when it comes to making decisions or acting in a certain way, an issue that has a direct relevance in the context of tax compliance.

*“I have friendly debates with other people who aren’t complying with the rules. A friend of mine is a carpet fitter but all his invoices just say supply. That way he doesn’t need to be part of the CIS scheme.” (Trade worker)*

*“We talk less about how to run a business, and more about how to hold onto more cash – tax dodges, avoidance, whatever you want to call it.” (IT worker)*

As with any business the primary objective for Sole Traders revolves around maximising profit, and saving money where possible. Key to this is obviously the concept of minimising tax liabilities, and remaining ‘open’ to opportunities to do so. However the extent to which an individual is willing to push the boundaries in this area is influenced by their attitudes towards taking risks. Interestingly, however, the majority of people within this study demonstrated the sense of a non-compliant mindset to some degree.

*“I shouldn’t really say this but I got a young lad on to help me out. Whenever I got a big job I got him in with me because I had worked with him before. I only paid him £20-£30 a day. Sometimes I get my other friend in too who is even better. I might put an extra £100 on the quote and get him in just for a day because he will do loads and really well in that one day. He does the same for me and I get more work. Say I do a £1000 job and he does £300 worth of labour and I don’t pay the tax on that but then say he does a job and I work for him and he pays the tax. We’re declaring but in different ways.” (Trade worker)*

The role of the network, where it is already inclined towards evasion, is to provide a constant vigilance regarding potential opportunities to pay less tax. For personal networks (or business and personal networks that closely overlap) that are more inclined towards evasive behaviours, a greater openness in discussing ways to avoid tax exists. Key to this is the (perceived) relative ‘safety’ of the environment, where trust levels are high. The closer a network, the more it wants to help each other out, and there is often a collective desire to beat the system. For these individuals, this type of behaviour is seen as ‘part of the game’. The fact that Sole Traders believe they do not have the same ability to play the game as big businesses, and feel they are always worse off and victimised by the system, only works to strengthen these attitudes.

*“You get influenced by friends you say ‘you don’t need to pay for that’ – if they’re not going to pay, and they’re going to save money in the process, then you won’t pay either.” (IT worker)*

Whilst behaviours are formed and moderated over time the advice of trusted accountants / book keepers can present spontaneous opportunities for those who previously saw none. Because agents are held in such high esteem – they are considered ‘experts’ and ‘trusted sources’ – they can be extremely influential when it comes to changing people’s behaviour. However, whilst business networks will often influence behaviour they are less likely to instil a shift in attitudes amongst individuals. Personal networks often have a greater influence in this department hence, whilst the business network may present an opportunity to save money by stretching legal boundaries, the individual is likely to reject the idea if they and their partner / group of friends have always strived to ‘play things by the book’.

### 5.1.9 Role of the agent

Agents (e.g. book keepers or accountants) have a key role to play when it comes to influencing the attitudes and behaviours of Sole Traders. They are considered ‘trusted experts’, and act as the filter through which questions relating to finance and tax are passed. In reality, however, the level of ‘expert’ advice received can differ due to the varying levels of expertise possessed by different advisors. For example, fully trained accountants will, more often than not, possess greater levels of understanding than standard book keepers, specifically in the area of HMRC practices and regulations. This has the potential to vary the levels of advice received by Sole Traders, including in the area of tax compliance.

Due to the Agent role as 'trusted advisor' they will greatly influence the compliance of individual businesses; however any advice/ guidance is likely to be given within the appropriate legal framework (as it is understood by the agent). It is unusual for Sole Traders, regardless of attitudes to risk, to discuss potential rule breaking activity with their agent. In fact, any questionable/ avoidance amounts and transactions will very much be kept 'under the radar' of Agents by individuals so as not to compromise their position. In reality the potential for most self-employed businesses to enter the realms of sophisticated tax avoidance schemes are remote, hence this is not typically discussed with Agents. However, ensuring all taxable benefits are received (i.e. tax efficiency – minimising tax obligations within the rules) will be a constant topic of conversation – both Sole Traders and Agents work on the basis that 'evasion is illegal, avoidance is legal'. Useful information gleaned in these instances will be fed directly back to the networks as this will represent genuine commercial value for members, and will make the individual 'look good'.

In addition to often being the major influence on decision making they also have a key role to play with regards to HMRC – they act as the barrier to communication and contact. The vast majority of Sole Traders are quite happy to have no (or very little) interaction with HMRC, and this 'switched off' attitude is partly responsible for the low levels of communication awareness amongst the self-employed fraternity (explored in more detail in section 5.2).

As we have seen in previous research carried out for HMRC this desire to 'disengage' from HMRC, and let the agent take control, is driven by a number of factors:

- Dealing with HMRC is considered a 'burden' and a 'challenge';
- Considered time consuming, bureaucratic, confusing, frustrating;
- Many are concerned they will make mistakes, misconstrue information – not talk the 'right language';
- Not part of their remit = a key reason for having and paying an Agent;
- Ultimately it is not something they want to be doing.

#### **5.1.10 Transferring messages**

Messages that gain traction – both within and beyond a specific network – are those that have a direct and material relevance to the self-employed person, and the similar types of people they know (this will be different by trade / profession). Relevance is most often determined by the potential for financial impact (on the business) – for example, a tax benefit has an obvious relevance, whereas information regarding a tax penalty does not as there is not reward to be had for the recipient. Individuals achieve a high level of pleasure and assumed 'kudos' from passing on benefit messages to others – the sense of self-satisfaction is a key driver.

Audits and investigations will often spark debate amongst networks and, once the details have emerged, are seen as learning opportunities in terms of what to be wary of in the future.

### 5.1.11 Network membership – summary of benefits

Respondents are clearly able to articulate the benefits of belonging to a network. Some benefits are associated more with some types of network than others:

- Building prospective clients and contacts;
- Driving sales and commercial value;
- Sharing useful information and advice (including from a financial / tax perspective);
- Gaining reassurance (knowing where you stand in relation to others on the ‘compliance scale’);
- Creating consistency (in terms of how members present their tax returns so that no one stands out and ‘becomes a target’);
- Developing a better understanding of how HMRC works (and what to look out for);
- Building reputations (amongst hard core groups of Rule Breakers there are clear reputation benefits to be gained from successfully ‘playing’ the system, and being successful).

## 5.2 Understanding the influence of HMRC activity on networks and assessing the awareness of HMRC messages

### Overview

- This research indicates that the understanding of the broader mechanics of the tax system is limited for the vast majority of Sole Traders.
- An individual’s tax awareness and understanding can be directly influenced by networks and their ability to transfer messages effectively and efficiently.
- The Agent (for those who use one) is the most significant source of information when it comes to issues of tax compliance. Importantly, they are perceived as trusted individuals with high levels of knowledge and expertise.
- Awareness of HMRC messaging is extremely low across the Sole Trader community and communications fail to gain traction due to a perceived lack of value or benefit.
- Sole Traders show little or no interest in the details of penalties, even if they are aware they exist. Consequently this drives low levels of engagement in media communications that promote these messages – this low involvement works to dilute impact.

### 5.2.1 General awareness of HMRC and the tax system

All Sole Traders interviewed knew of HMRC; however many still refer to it as ‘the revenue’, the ‘taxman’ or ‘customs’ (for VAT) demonstrating the importance of legacy perceptions where tax is concerned. Levels of understanding in relation to what it does and how it operates differs across individuals; however this tends to have a direct correlation with levels of understanding relating to personal tax responsibilities. The general perception of HMRC is that ‘they exist to collect taxes from the public and business to support public services’.

Most Sole Traders claim to have a limited understanding of the broader mechanics of the tax system, especially those running smaller businesses with turnovers of approximately 20-40K. However, due to the more complicated tax procedures of VAT registered companies, individuals incorporating the VAT process into their tax dealings appear to have a better understanding of how the system works overall.

General awareness of specific penalties is very low across the sample, although all are aware that penalties exist for late payment, if not always what the penalties actually are. This is important as it demonstrates that it is not a major determiner of behaviour. The penalty rather than the severity of the penalty is what influences perceptions, as there is knowledge penalties exist (in the abstract), but there is also very limited knowledge of the specifics e.g. that interest is payable on tax not paid. In essence the existence of the penalty is acknowledged, but the specifics are of much less relevance. The primary desire is not to incur any penalty as this is also tied strictly into the Sole Trader desire to remain 'off the radar'.

Whilst there is a general acceptance that greater awareness will enhance their performance as Sole Traders, and probably benefit their business financially, the desire to grow levels of understanding is conspicuous by its absence for most. Key to this is the perception that they lack the time and resources to educate themselves due to the fact that so much time is taken up running the business itself. Importantly, there is a widely held opinion that Sole Traders neither want, nor need to be experts in the field of taxation to see their business function efficiently. Ultimately what they need is an effective understanding of the basic process (e.g. filing and payment dates) and the fact that penalties exist should they not file or pay bills on time. If information is required beyond this they will contact their agent (if they have one), contact HMRC, or speak to friends or family members who have experience in a specific area. Expertise in tax is not widely desired or valued, rather a simple ability to not let meeting their obligations to HMRC get in the way of running their businesses is their core concern.

### 5.2.2 How messages are propagated

Networks – and the transfer of messages within them – can have a direct impact on the tax awareness of individuals as the network is an important communications channel for Sole Traders.

*“I give tips to some friends that are not familiar with the self employed tax system. Or other times I get tips. Like when I was at this workshop the other day and I found out that if you have a bike you can offset some of the costs” (IT worker).*

Sole Traders receive messages to do with tax and compliance from a variety of sources:

- Agents (accountants, book-keepers etc.);
- Word of mouth (social and business);
- Online forums / networks;
- Broadcast advertising;
- The media (TV, Print and Online);
- HMRC (Direct Mail and online).

For those who use an Agent, they are the most significant source of information when it comes to issues of tax compliance. They are trusted and influential as they are perceived to be an expert source of knowledge, although they are not necessarily registered practitioners and there is a divergence of quality across the Agent space with 'good' and 'poor' Agents in terms of technical expertise as well as tax technical knowledge.

Information gathered from Agents or other professionals (e.g. solicitor) often makes its way into the network (e.g. the £100 penalty for late filing is a message commonly voiced by accountants, although not always remembered). However, as explored earlier, messages are only likely to get transmitted if they possess a genuine relevance for the recipients within the network. The most commonly conveyed messages concern what can be saved or offset against the tax bill (legally) to ensure the best deal for the tax payer. There is little incentive for the individual to pass on more transactional details, or information messages from HMRC, as the value of this type of information is limited and is unlikely to increase their status or stock within the group. Transactional information is low interest and as such of little value or relevance to network discourse.

### 5.2.3 Awareness of HMRC messages

With the exception of the Self Assessment campaign there is little awareness of HMRC messaging within the sample. The primary sources of information on tax are the tax agent (accountant or book-keeper) or the network, which are both fuelled by information which starts in HMRC announcements or guidance but which is mediated through the myriad of routes – formal and informal – that it enters broader circulation. The majority of information is transmitted in some way or other by Agents, in particular accountants and accountancy representative bodies.

**Illustration 5.2.3:**

**Moira Stewart Self Assessment TV ad**



It is striking that there is little formal recognition of HMRC messaging by Sole Traders and how for most, beyond their professional advisors there is little formal recognition nor interest in messaging around tax or tax compliance. What is clear is that messaging around record keeping or compliance is of very low interest and therefore as a consequence is often either not consumed or ignored.

HMRC communications do not have traction with the Sole Trader audience and are often believed to be simply a restating of information on 'what is required', rather than believed to be of value or offer helpful information or advice. It is clear that HMRC messaging on compliance penalties has not permeated the Sole Trader audience as there is almost no real knowledge beyond the £100 late filing penalty and a broad awareness of fines (of some kind) for late or non-payment. In short, where penalties are discussed the primary penalty believed to exist is imprisonment, although when rationalised, this is not believed to be relevant as a threat for low level evasion.

There is no awareness, across the sample, of 'Name and Shame'. On discussion most comprehend how the idea is *likely* to work and, as such, it gains very little traction. Respondents of all types are dubious of both its practicality and potential effectiveness. Of particular concern is the thought that your business could get 'named and shamed' in a case of mistaken identity, or due to an admin error by HMRC.

*"You could have twenty years hard work go down the drain. And what if you've had a totally clean slate up until now and you make one silly mistake, or have one late payment, now that's not exactly fair... it certainly won't make relationships any better that's for sure."* (Trade worker)

#### 5.2.4 Impact of HMRC activity on networks

HMRC does not overtly influence network activity in the eyes of those in the network, but it clearly does influence networks in that all information on tax ultimately emanates from HMRC, its rules, guidelines and other knowledge bases. Tax agents, accountants and other professionals are the primary vehicle for information transfer into networks as they are the trusted advisors of Sole Traders.

The 'Agent' channel is the most important opportunity for HMRC to influence networks, but this is mitigated by the need for information to be seen as 'of value' to Sole Traders, otherwise it is unlikely to really permeate network discourse. Currently HMRC does not actively leverage the Agent channel to the extent it might, as it is clear that messaging around penalties and record keeping have not permeated as much as they might have. This remains a major opportunity for HMRC to leverage the influence of trusted advisors as a communication channel to influence the Sole Trader population.

### 5.2.5 Trade versus IT

There were no real discernable differences between the two Trade and IT groups in terms of how messages are transferred or the impact they appear to have on the Sole Trader audience. There is a clear 'educational' difference between the two groups which influences behaviours, but in terms of messaging and the traction of messages there is actually little real difference between the groups. It appears that issues such as 'previous experience' or the experiences of others have a much greater influence on behaviours than industry type in this case.

## 5.3 The impact of social norms on general attitudes to government provided services and paying tax

### Overview

- Anti-government attitudes are a prevailing theme across the research, regardless of the nature and type of a business.
- The Sole Trader fraternity, on the whole, feel hard done by and the general consensus is that government are doing very little to help their plight which has been worsened by the current economic climate and the business challenges this has created.
- Financial pressures – driven by the current economic situation – and an overall sense of injustice is having a direct impact on the behaviour of some Rule Breakers; they are using it as a justification to not declare earnings (on specific occasions).
- Paying less tax is an acceptable part of being self-employed – all Sole Traders consider tax efficiency to be good business practice and will actively seek out, and be receptive to, ways to minimise their tax liabilities.
- Small traders perceive their evasion behaviour to be 'low level' and hence unimportant in the wider scheme of non compliance. For many this drives a belief that they will go undetected by HMRC; a perception strengthened by the belief they are not the primary focus of HMRC enforcement activity.
- 'My money' (where cash is received and tax not declared) is defined as 'weekend jobs', or 'jobs for friends'. Whilst a consistent feature of both Potential Rule Breaker and Rule Breaker behaviour, this type of non-compliance is kept to a minimum (per Sole Trader) so as not to generate unwanted attention.
- Many perceive being above the VAT threshold to be an unattractive prospect – if can often place the business at a competitive disadvantage.
- Many small businesses take positive actions to avoid the VAT threshold, and this can include the non-disclosure of income.

Tax **efficiency** (in the eyes of the Sole Trader, the legal organisation of financial affairs to minimise tax liabilities), **avoidance** (the legal manipulation of tax regulations to reduce tax obligations) and **evasion** behaviours are fostered through those networks that are already inclined towards cheating behaviours. It is unlikely that a network not already oriented (by the weight of attitudinal leaning in the network) towards such behaviours will suddenly alter its guiding perspectives, rather than such shifts would be gradual and down to changes in network membership. The determining characteristics in this context are the social norms of the group, which are in turn informed and mediated by the personal norms of those within the network.

### 5.3.1 Personal vs. social norms – towards a clear definition

Social norms represent a guide on how an individual should act and behave, and how he or she expects others to behave. These may be *descriptive*; what is done, based on the observation of the majority of others. Or they may be *injunctive*; concerned with what others think ought to be done. For example, there is a prominent prevailing social norm amongst sections of the self-employed population that says paying less tax is an acceptable perk of the job, to off-set the inherent uncertainties of working for one's self (versus PAYE).

Personal norms are internalised norms, felt by the individual as a sense of moral responsibility to help others. They represent the lens through which everything else is heard and are a product of deep rooted demographic characteristics, such as education, social upbringing and family situation. Whilst these are important mediators to understand they are not the concern of this work.

### 5.3.2 Group norms

Demographic groupings give rise to group norms, such as those within a given network of individuals. The influence of these group norms on the individual is typically influenced by the emotional closeness of the people within the network. Social networks, where the process of development has been longer and emotionally manufactured, are going to be made up of individuals who possess similar personal norms, attitudes and behaviours. Business (and circumstantial) networks contain a wider range of personal norms, many of which may not be considered appealing / relevant, thus its ability to influence the individual on a personal level will be reduced.

Across all stages of the research a widespread acceptance of low level evasion has been prevalent. At the micro level – across groups of Rule Breakers (and occasionally some Potential Rule Breakers, albeit less systematically) – individual networks of like minded individuals are working to create a sense of acceptability when it comes to low level evasion or 'cheating'. In a sense they are helping to normalise this type of attitude and behaviour. For example, there is pervasive discussion of cash work representing 'beer' or 'pin' money – the type of work one does on the cheap as a 'favour' for family, friends, friends of friends etc. Where the group is inclined towards low level evasion there is a tendency to justify cheating behaviour as 'normal' or 'just getting when you're due'.

*“I don’t see it as cheating, I see it more as common sense. I don’t know anyone who does bits of work at the weekend and doesn’t pocket all the cash. In the week that’s different, but not when I’m doing a little job for a mate.” (Trade worker)*

Ultimately, what is considered ‘justifiable’ differs by group and it is the network / group that defines the levels of acceptability for individual members.

*“I was once on this job and this guy said that he had managed to get 3-4K back from the taxman. I would be worried if I had got that. If my accountant was putting that through, I would be worried. If I got back £300 I wouldn’t be worried. Some people claim for everything.” (Trade worker)*

### 5.3.3 Perceptions of the tax system and levels of fairness

Prevailing themes of anti-government attitudes exist across the sample from web designers to plumbers, which reflects the broader picture of attitudes towards the state that have been assessed in previous work (e.g. the SME Customer segmentation completed prior to this work). These attitudes have certainly been exacerbated by the unpredictability and uncertainty of the current economic climate, and the continued difficulties small businesses are faced with regarding financial support from banks. All of those interviewed claimed to be struggling currently to some degree, or knew other businesses who were. The general consensus is that government is currently doing very little to assist the plight of the self-employed, and this has led to a consistent build up of animosity over the past two to three years. Sole Traders see themselves as the ‘target’, and they always feel they are having to take a hit of some description or another.

*“You end up taking cash jobs and not declaring even though it’s a pain in the back side there’s only a number of things you can buy with cash from Tesco’s. I would like to be able to put everything through the business and be absolutely clean and crisp. I am a small business and sometimes it would be easier for me to not go on trading. There isn’t enough incentive for people like myself to go on and do it completely legitimately.” (Trade worker)*

This perception is aggravated further by the insistence that too much is being done to assist the continued growth of larger organisations, whilst ‘they let the life-blood of this country fade away’. It is important to stress that, whatever the reality, these perceptions are a genuine influence on the attitudes and behaviours of the self employed.

*“I think more of big businesses scamming the tax system. There are tons of ways that the tax is done that businesses can have a lot of evasion. If you’re clued up, it’s made so people can offset things. If you’re big you definitely don’t need to pay much.” (IT worker)*

For many, this sense of unfairness has now given way to greater feelings of alienation from both the system and society itself. Whilst most appreciate they have to pay tax, they believe the current tax system penalises them for working too hard, and they struggle to accept the current levels of tax they are being asked to contribute. They believe they are being asked to contribute too much of their own money and that the system is biased in favour of big business that can pay business advisors to create avoidance schemes. 'Unreasonable' is very much the feeling that prevails. Consequently, paying tax is seen *less* as a contribution to the greater good, and more as another penalty for having a job and providing a valuable service to the community. This audience is waiting for their interests to be recognised and protected and, until they believe this is happening, and / or their financial outlooks improve, this sense of injustice will be hard to break down.

*"At least I'm not claiming benefits, I've chosen not to. I'm busting my gut to keep my head above water, so why penalise me." (Trade worker)*

Amongst trade workers a simmering resentment exists relating to the *perceived* belief that many jobs in their industries are going to people from other countries. This situation demonstrates the influence prevailing media stories can have on both individuals and their broader networks. These people are felt to be exploiting the increasing public desire to 'pay less' for trade based work by offering to do work at vastly cheaper rates, resulting in them becoming uncompetitive regardless of the belief they have greater skill levels. This has led to many trade workers having to reduce their rates which, in turn, has had a direct impact on some when it comes to declaring earnings (discussed in more detail later in section 5.4: 'Tax compliance in a weakening economy'). Regardless of how accurate their beliefs are, this situation is exacerbated by the perception that 'these people' are also not paying their own taxes, meaning they are not only losing work to 'foreigners', but they are also having to fund their existence through the payment of their own taxes. This thought also applies to people who are felt to not *want* to work – perceived 'state scroungers'.

For some trade Rule Breakers these beliefs – and the sense of injustice – are having a direct impact on their behaviour as they are using this perceived situation as justification to not declare all earnings. Due to what we know about this audience we can predict they will be looking for opportunities to break the rules anyway, suggesting these justifications are merely acting as excuses to engage in non-compliance. The research suggests these types of personal norms, and associated behaviour, are likely to be shared by the individual's close network of friends, many of whom will be working in similar professions. As such cheating behaviours are reinforced.

Paradoxically, however, Potential Rule Breakers often possess more extreme perceptions of unfairness than Rule Breakers due to the fact their personal norms, and those of the broader group, ensure they always declare all their earnings, regardless of frustrations. Because Rule Breakers tend to pay less tax they are often, in reality, *less* frustrated by the perceived injustices of the system and have a greater sense of control over their contributions.

Networks have a key role to play when it comes to creating and driving perceptions. Media messages (e.g. tabloid newspapers) permeate networks, which then work to build and perpetuate the perceived sense of unfairness. When messages of unfairness have cemented themselves amongst the group the network starts to sustain them as a shared belief, and these thoughts will then be shared with additional networks over time.

Ultimately, the perceived fairness of the tax system goes a long way to dictating the levels of compliance seen across businesses. Perceived fairness is also likely to be linked to an individual's motivation to pay tax – i.e. the degree to which they see it as something they should do, versus something they have to do. Those who view the tax system with a greater degree of fairness and altruism are more likely to be compliant than those who do not. This has very much been reflected by previous research conducted with both Rule Breakers and Potential Rule Breakers, where prevailing perceptions are that the system works against them.

#### 5.3.4 Why do the self-employed pay tax?

Regardless of an individual's motivations to pay tax, all self-employed businesses would rather pay less. Reducing the tax burden of the business represents a consistent and unsurprising objective and, whilst individuals may not be actively seeking out opportunities on a day to day basis, they will always be open to the ideas (messages) of people within the networks which help make their business more profitable.

Whilst different levels of altruism and moral awareness prevail, the payment of tax – for both Rule Breakers and Potential Rule Breakers – is very much something enforced rather than done on a voluntary basis. For the vast majority it is seen as a 'necessary evil' – something you have to do, and should do, for the sake of the country as a whole (e.g. to support public services). However, as we find, most Sole Traders are predominately driven by the fear of getting caught and having to pay the penalties. It is clear that different perceptions of risk mean some self-employed businesses are willing to push the boundaries more than others. This is mostly driven by the individual themselves; their personal norms, and their propensity to take risks. Networks have an ability to influence these perceptions but are only 'an influence' as opposed to the 'primary influence'. However, Sole Traders often feel they are small enough to avoid detection, and believe they are not the primary focus of HMRCs enforcement activity. When an individual feels strongly enough that they are off the HMRC radar they are more likely to push legal boundaries, for example cash based trading or overstating costs or industry sales.

#### 5.3.5 Perceptions of risks

In addition to one's personal norms and approach to risk, when analysing the research it becomes clear that the propensity to take risks is driven by several factors:

- Previous behaviours – and what they have experienced by way of consequences.
- Demographics:
  - Age (younger people tend to take more risks, especially if stakes are small).

- Gender (men tend to take more risks than women).
- Life-stage (single people tend to take more risks than those with families).
- Awareness (linked to education and knowledge of consequences).
- Stage of growth – a younger business may take more risks, partly because their perceived financial need is greater, and partly because a more established company has more to lose.
- Degree of responsibility for others– again, driven by how much is at stake. Someone with a family and house etc. is less likely to take risks than a single person with only individual responsibilities.

*“Whilst my kids were growing up I wanted to have a full-time steady job where I knew I had a salary at the end of the month. But I always wanted to work for myself and now I can because the kids have left home and it’s just me and the wife. We don’t have a mortgage which makes things easier.” (IT worker)*

Perceptions of risk, and risky behaviours, are also influenced by external factors – the current economic climate is a major example of this. The recent recession has had an impact on the sharing of tax saving messages across and within networks, with the push and pull of information increasing as people consider taking more risks. As the pressures of the economic reality hit home there has been a genuine impact on the willingness of many individuals to:

a)Assess things that would not previously have been considered.

b)Adopt more risky behaviours in relation to non-compliance.

There is evidence to suggest that a shift in what is considered morally justifiable is happening within networks, and this has the potential to change group norms in the context of what is considered acceptable behaviour when it comes to taking risks. This could potentially start to have an impact on the conduct of Potential Rule Breakers, moving them – for a while at least – into Rule Breaker territory.

*“Do I take more risks? I can see why people do. It’s much more difficult to get work these days. I know for a fact that people I know are doing things now that they wouldn’t have done in the past, and if one person’s doing it others think ‘if they’re doing it, I’ll do it too’. It’s a matter of survival at the end of the day”. (Trade worker)*

*“If a plasterer is working for me for a day and I pay him £300. I have to take that out the company account and declare that as wages and give them the cash. Then I declare the overall invoice too. In affect I’m paying their tax for them. That annoys me. So therefore doing the odd day for my friend and getting paid and not declaring then that’s ok because I’m over declaring anyway.” (Trade worker)*

### 5.3.6 Working to reduce tax liabilities

All Sole Traders consider tax efficiency to be good business practice, and ultimately a business and personal right, to the extent that an ability to successfully 'play the system' is associated, amongst networks, with credibility, whereas paying 'more than you need to' is often seen to reflect an individual's lack of awareness and success as a business person. There is a large degree of interest and activity within networks when it comes to tax saving attitudes and advice. The sharing and transferring of information is seen as a way of keeping up to date with the latest and most efficient best practices when it comes to paying less tax. The extent to which these messages impact on behaviour, however, is dictated by the credibility of the source. Messages driven by agents are considered to be more trustworthy and will tend to have a direct influence on the attitudes and actions of those in the group. Messages entering a network from an unrecognised, less trusted, source will be greeted with a greater sense of caution. In this scenario individuals will often filter these messages through their business networks or their accountants to assess their validity before putting them into practice.

The level of risk taking associated with tax saving messages is typically determined by the type of network involved. A social network – where trust levels are higher, and people are less protective of the image they are projecting – will tend to be more open and willing to discuss tax saving options that are quite clearly perceived as rule breaking if, as a group, they are more open to pushing boundaries. The extent to which these messages impact on behaviour will be dependent on the individuals within the group, and the extent to which they harbour Rule Breakers or Potential Rule Breakers tendencies.

In contrast to this, business networks tend to exhibit a more cautious and methodical approach. The relative comfort and safety of the social network gives way to a more unpredictable environment, one that will impact on the desire for an individual to expose themselves too much. The key objective for each member in this context is to retain an air of professional integrity and credibility; this could well be undermined by the introduction of thinking that is considered out of bounds to the group as a whole. However, once an individual has begun to understand the norms underpinning group thinking and behaviour, these types of messages could start to be introduced if he/ she believe it will not undermine their standing amongst the group.

There is also a practical dimension controlling the behaviour of business networks, as an audit or investigation might bring fellow members under scrutiny – consequently a sense of self preservation permeates attitudes and a mutual protection of network members occurs through the consistency of behaviours.

Group norms operate in social contexts, and this provides different networking opportunities for trade workers and IT professionals. By its very nature the trades industry is more social (e.g. site work, regular drinks) and due to the greater levels of social interaction there tends to be a greater overlap with social networks. This may well lead to greater levels of emotional engagement and trust building up within the network, increasing the likelihood of non-compliance messages being shared. IT workers have less opportunity to mix on a face to face basis due to the fact they are working alone for a large proportion of the time, hence the opportunity to share messages in the same way is reduced. Whilst IT workers will supplement the lack of face to face contact by joining virtual networks (both social and business) these channels are less likely to instigate discussions around non-compliance issues, although they may well offer advice and opinions relating to tax overall. Whilst the online platform offers up great potential from a variety perspective losing the face to face dynamic, and the emotional drivers of trust and reassurance, mean messages lack the required level of credibility. Any potential ideas would need to be clarified further via a recognised and trustworthy source.

There is evidence to suggest that Sole Traders are working in established business partnerships to avoid tax for mutual benefit. Essentially this represents a process of non payment for exchange of services – *“He builds some shelves for me, I fit a sink for him.”* (Trade worker).

### 5.3.7 Income versus ‘my money’

There is a clear distinction amongst many of the self-employed between what is considered ‘income’ (money which is put through the books) and the concept of ‘my money’ – cash jobs that go straight into the pocket of the individual. This perception, and the behaviour it encourages, is shared by both Rule Breakers and Potential Rule Breakers. Key to this situation is the belief that these actions are not typically viewed as illicit behaviour, or evasion – either by the individual or their core networks who will often share a similar mindset. ‘My money’ jobs are generally seen as ‘favours’ versus work per se – helping someone out, family and friends, often at the weekend, involving cheaper prices (‘mates rates’).

These types of behaviour are largely dependent on the expectations and trust of the client. The opportunities are created by networks, either a social network, or via a business network where a specific personal relationship has started to emerge and establish itself. In this context Sole Traders are driven by a collective mindset that suggests they are ‘doing nothing wrong’, hence the idea they are breaking rules and exposing themselves to penalties is missing from the decision making equation. However, because very few fear being reported by members of the network, and because most people they know are doing the same, this type of activity is unlikely to dissipate. It is currently an established distinction for all Rule Breakers.

This type of activity lends itself perfectly to the trade industry where a plethora of small, quick turnaround, yet valuable cash jobs can present themselves. However it is also relevant for the IT industry (especially smaller companies) as people often need websites to launch new businesses, ideas etc., or need help fixing or programming their computers. ‘

*“I was teaching a few students. It was a couple of hours I didn’t put in my tax but at the same time there were a few expenses I didn’t put through. So it balanced. Obviously if I was to do everything 100% clear, I wouldn’t have done that but it’s never above a small amount.”* (IT worker)

‘My money’ tends to be spent differently than income, positioned more as ‘spending money’ and paying for everyday items such as food shopping, holiday funds, cigarettes, alcohol etc.

*“It’s ok to work for cash when you’re working for friends. It’s like saying the job was £500, buy me a few drinks. You could argue that is a big drink.”* (Trade worker)

For most people interviewed the number and size of these jobs will be kept to a minimum for three key reasons:

- Most want to avoid doing large cash jobs – to limit overall risks.
- There are limitations to how much money one can spend before raising suspicion (it is recognised that ‘spend’ as well as income can raise the alarm bells).
- Making too much money in this fashion will see the method lose its current sense of innocence.
- The justification for ‘my money’ – or low level evasion – is further supported by macro issues. Most believe their behaviour to be low level and unimportant in the wider context of tax not paid, which is considered far more of an issue amongst large scale corporations adopting tax avoidance schemes and transfer pricing. For both Rule Breakers and Potential Rule Breakers the prevailing belief is that a moral distinction exists between the behaviour of the self-employed and big businesses and it is these social norms that work to influence the behaviour of many.

As outlined in section 3.1 (SME Customer Segmentation – an overview), and highlighted further here, the key differences between Rule Breakers and Potential Rule Breakers is their attitude to risk and ‘getting caught’, and the impact this has on compliance behaviour. Essentially, the greater the level of risk attributed to an action the more apparent the behavioural comparison of the two groups will become – i.e. Potential Rule Breakers are likely to shy away from the action, Rule Breakers are more likely to embrace it. However, in the case of ‘my money’ jobs the level of perceived – and actual – risk is minimal; hence a more generic belief pervades both audiences, and more consistent behaviour emerges.

### 5.3.8 Impact of VAT threshold

On balance, being above the VAT threshold is considered a typically unattractive prospect for most Sole Traders.

*“The VAT threshold scares me. Our domestic customers don’t want to know because you’re more expensive than the previous week. I keep creating businesses so I don’t get there.” (Trade worker)*

Whilst for some businesses (e.g. those with more expansive growth strategies) it can provide credibility and status, for most Sole Traders it is associated with increased hassle, admin charges, and the ability to make a business uncompetitive (when being compared with non-VAT companies who are able to charge lower rates). Most businesses on the cusp of the threshold are reluctant to move above it, and some (not just Potential Rule Breakers) admit they will seek ways of preventing it happen either via ‘creative financing’ or a stretching of the rules.

The key issue for trade workers in the current economic climate is to remain competitive. Being VAT registered can jeopardise this for many as they believe they are likely to lose out on work to competitors offering cheaper quotes not incorporating VAT costs. Trade workers are often at the mercy of market dynamics, as the desire for cheaper quotes is being driven by clients who are also looking to save money in the economic down turn.

*“People are actually saying to us now that they don’t want to be paying VAT. They’re actively seeking out companies who are not VAT registered so they can get work done for cheaper. Some will even get our original quote and then offer to pay less, cash in hand, basically encouraging us not to declare it. That’s what we’re up against!” (Trade worker)*

This is less of an issue for trade businesses working on commercial projects, where clients will typically be expecting to pay higher prices and leave a ‘paper trail’, and also IT workers whose clients also have different expectations, typically preferring the credibility and security associated with VAT registered companies.

## 5.4 Tax compliance in a weakening economy

### Overview

- A combination of circumstances such as competition, pressures to reduce prices for jobs and a fragile economy are making it more justifiable to not declare income.
- Sole Traders are apprehensive as to what the future will hold – for both their business and their personal situations – hence levels of pressure are high.
- The perception of an unfair tax system combined with the existence of increased competition, has contributed to changing attitudes towards the tax system and specifically paying ‘on time’ and ‘on all their income’.
- Individuals on the verge of the Potential Rule Breaker segment are most at risk when it comes to exhibiting Rule Breaking behaviours.
- Evidence emerged from the interviews that suggests, due to external pressures, previously legitimate Sole Traders are now willing to take risks – i.e. behaviour is actively being changed.
- In a weakening economy Sole Traders are more likely to avoid the VAT threshold.

### 5.4.1 Pressures on the self employed in the current economic climate

The body of the report has necessarily brought in discussion of the impact of the economic downturn since 2007/8 as this has been impossible to completely untangle from the other three core objectives of this work. The recent economic downturn has put increased pressure on Sole Traders and all respondents involved in the research showed how they had personally experienced the recession having an impact on their business, or they had heard about others – in and outside their networks – being affected.

Sole Traders have experienced the recession in many different ways and at different times. For example the construction industry is particularly sensitive to economic conditions and with many of the trades-people interviewed relying all or in part on this industry as a source of income, they have been particularly affected. Of the sample interviewed in this research, some were at the end of a difficult time where business was starting to pick up again, whilst others had recently hit difficulties. An overall spending freeze – or often decline – has been recognised by all, where both domestic and commercial clients are not investing in new products, services or developments and work has often been more difficult to win and also completed at a much lower rate.

*“I’m doing a bit of cash work. Not as much as I used to because people aren’t spending. It’s dried up a bit. People are putting off extensions, etc.” (Trade worker)*

There is evidence of a culture of apprehension as to what the future holds, both in terms of their business and their individual livelihoods. The external responsibilities of Sole Traders – mortgages, bills, and family – which places extra pressure on them and this has led to a culture of fear for some. There is a genuine concern for some that if business does not start to 'pick up' soon its very existence will be under threat. However, there were also examples in the research of businesses starting to not only sustain themselves, but also grow.

The cut backs in the economy have also affected Sole Traders in relation to being paid in a timely fashion therefore impacting cash-flow, which is the primary concern of all small businesses, and particularly Sole Traders. Some in the IT sector have experienced difficulties with being paid on time. The flow of money at this time is increasingly important to the functioning of Sole Traders' businesses and is absolutely causing difficulties for many businesses. A lack of funds is certainly something which has the ability to influence a change in behavioural mode for those more minded to take risks, and will provide further justification for those already minded to cheat on their taxes.

Many Sole Traders interviewed revealed that they had recently been working very long hours just to make ends meet, which is a consequence of the dynamics of running a Sole Trader business, where essentially time equals money. In recent years, some businesses had not made any profit and were just making enough money to pay bills. Often in these cases Sole Traders were not taking a wage from their business or simply taking enough to 'get by'.

However, the most significant pressure on Sole Traders from the weakening economy is increased competition. The spending freeze and large-scale cut backs have forced a large number of businesses to compete for a small amount of available jobs, putting a premium on costs and in essence driving down market prices. Sole Traders perceived the following to be the main areas of current competition:

- Competition from traders offering cheaper quotes that do not incorporate VAT costs;
- Competition from un-registered workers (for example, Electricians who were not safety registered) were able to offer cheaper quotes because they did not have to factor in the time spent on registering work;
- Competition from immigration where people are able to offer cheaper hourly rates (this was particularly relevant for trade workers);
- Competition from an increase in Sole Traders working for cash jobs.

The array of different pressures experienced from the recent economic downturn has had a particular significant impact on potential rule breakers' attitudes towards tax. Section 5.4.2 outlines these changes to attitudes.

#### 5.4.2 Attitudes towards tax and potential changes to behaviour in a weakening economy

The perception of an unfair tax system combined with the existence of increased competition, has contributed to changing attitudes towards the tax system and specifically paying 'on time' and 'on all their income'. This is far from a universal shift and in terms of the segmentation which forms the basis of this research, it is those individuals on the margins of the Potential Rule Breaker segment, that are most likely to begin to exhibit more Rule Breaking behaviours.

Many across the sample reveal that the economic downturn has provided a number of Sole Traders with – in their eyes – legitimate reasons to not comply with the tax system at this uncertain economic time. There is evidence to suggest that traders who may not have done so previously are now willing to take risks as it is recognized to be a 'morally justifiable' time to not comply due to external pressures. These attitudes have been shared across and within networks, and are compounded by the general belief amongst the self-employed that small businesses are dealt an unfair deal by the state in comparison to larger corporations.

*"Well they're all looking to save money so tax is obviously one of the ways to do it."*  
(Trade worker)

It is also perceived that some will take the opportunity to utilise the fact that they could declare less tax as it is something expected at this time.

*"I think there will inevitably be some people, who would tend to be the less scrupulous people, who will use the opportunity. You know, if I were a builder and I were getting less business and I was finding it difficult to pay my mortgage, then I might be more inclined to declare less of it. I'm not in that situation so I can only imagine."* (IT worker)

In addition, the greater focus placed on earning money at this time of economic uncertainty means that for some they have put less effort into completing tax forms correctly as they can (a) not afford the support of an accountant or (b) cannot spend quality time completing the recommended process of self assessment. This could have a detrimental effect on the quality of submitted paperwork and this may need to be monitored by HMRC.

*"I spend more time working at the moment rather than keeping on top of the paperwork. My philosophy is that I have to work to pay the mortgage, it's a constant battle. It's an important thing but when you have customers they come first rather than the paperwork."* (Trade worker)

## 6.0 Conclusions and Recommendations

### 6.1 Segment and trade differences

There are differences between Rule Breakers and Potential Rule Breakers in terms of attitudinal make up. However, when it comes to the propagation and awareness of messages, and network behaviour and influences, differences are negligible and both are open to the pressures of the economic climate. It is clear that networks have the potential to influence the compliance behaviour of Potential Rule Breakers over time as the continued exposure to different ways of 'playing the system' creates opportunities and provides encouragement. The key influence of the network in this context is to influence the Potential Rule Breaker's perception of risk, making low level evasion seem 'less risky'.

There are no differences between IT professionals and trade workers when it comes to the propagation of messages and the level of traction afforded to some versus others. The messages Sole Traders – across the sample – want to hear and talk about are those with a genuine value (typically commercial) for either the business or themselves. Past experiences or the experiences of others have a far greater influence on behaviour than industry type. Although the pressures of the weakening economy are being felt by all the more 'cash based' structure of trade working makes it easier for self-employed trades people, with a rule breaking disposition, to not declare all income earned.

### 6.2 Impacts on behaviour

Networks do influence Sole Trader behaviours as the network is the source of knowledge and information which Sole Traders use to inform their decision-making. In terms of compliance the network influences positively as well as negatively, although it appears that the 'opportunity' to 'safely' evade (i.e. evade at lower risk) is a message with much greater traction than messages around investigations or others getting 'caught' as Sole Traders appear to believe there are many examples of people 'getting unlucky' or 'being greedy' and as such getting themselves into trouble. In these cases the risk reward calculations tend to favour supporting lower level evasion as a 'victimless crime' that is 'justifiable' and 'easy to get away with', in particular for those segments with attitudes more inclined towards cheating.

Individuals are the biggest determining factor in influencing behaviour, not the network, as the individual is an independent actor in a network and the consequences of one's actions are personal and do not impact the network in the same way. The network is an important factor which can influence specific decisions much more than they are likely to shift deep-rooted attitudes or behaviours. As such in a specific event – e.g. an opportunity to do a cash job – the network can provide enough weight of evidence and/or justification to influence that individual decision, whilst the individual would essentially remain usually not prone to cheating.

Macro-economic factors are a key influencer in that they change circumstances and so change the risk / reward calculations of individuals. Economic pressure on individuals can force behavioural shifts, in particular where the individual needs to reassess living standards. Many Rule Breakers and Potential Rule Breakers claim to have minimum standards below which they are unprepared to drop and when forced they will begin to take more risks to retain a minimum level of income.

### 6.3 HMRC messaging

There is a large scale lack of awareness of HMRC messaging with the exception of the Self Assessment campaign. Sole Traders express very limited awareness of HMRC penalty regime or self assessment requirements beyond the very basic (e.g. £100 late payment penalty and/ requirement to retain all records for 6 years). The reason for this low level of awareness is primarily due to tax being a very low interest category for the Sole Trader for whom tax issues are only important at particular times of year i.e. when payments or filing is required. Sole Traders express a desire to keep as much of the process of compliance away from them as they can. For this audience time (or lack of it) is a genuine lifestyle pressure and protecting it for the purpose of work commitments is essential. Time spent on tax issues is considered both 'annoying' and 'unnecessary'.

*"I don't want to spend hours and hours sorting out tax stuff. It's not what I'm good at. That's what I pay my accountant for."* (IT worker)

Messages that cut through are those which offer the individual Sole Trader a discernable financial or other tangible benefit. This is particularly true of Rule Breakers and Potential Rule Breakers who both have a more individualistic set of attitudes. They are more driven by personal gain than an appreciation of their role in wider society, and dissemination of these messages within the networks can add to an individual's status in the group.

It is clear that the communication of HMRC messaging needs to achieve greater levels of visibility and cut-through. Achieving greater communication success is essential in the area of compliance, and having a positive impact on attitudes and behaviours. This could involve greater use of broadcast advertising, or the use of Agents as channels themselves (via filtering messages to their clients), in an attempt to encourage the networks to have a positive influence of compliance. Key to this needs to be the debunking of certain myths, prevalent across the self-employed landscape, for example:

- The need to get across that small scale evasion by Sole Traders adds up to billions, and is not the inconsequential figure most believe it to be;
- Reinforcing the majority view that you need to declare all your income, and not claim for more than you are entitled to;
- Addressing the belief that every Sole Trader (and small business) is happy to carry out small scale evasion.

## 6.4 Driving levels of compliance

Work also needs to be done to communicate the consequences of non-compliance. Currently the benefits of committing small scale tax evasion are too 'real' for individuals; people don't get caught so they carry on doing it. Most Sole Traders see it going on around them (e.g. friends, workmates), or hear about it through the networks. It's something they can feel and touch, it's often very easy to do, and it brings financial rewards, which creates genuine temptation for those with a higher propensity for risk taking and with rule breaking tendencies. The downsides, however, are less real. Very few have been audited or challenged by HMRC, fewer still have actually been fined and/ or had their businesses (and livelihood) threatened as a result. The potential 'pitfalls' need to be brought to life and made more clear. For example, the accumulative growth of penalties is an eventuality very few are aware of, however it is one that has the potential to surprise and shock. Telling stories like this – ones that are based in fact and demonstrate the damage non-compliance can have on your business – has the potential to influence attitudes and behaviour.

Agents – accountants and book-keepers – are the single greatest influence on the individual Sole Trader. They are the trusted advisor and source of 'formal' knowledge. This trust is based on the belief that they are the implicit experts in financial business matters, in particular the area of compliance rules and regulations. This explains why much, if not all, of the compliance process is essentially outsourced to agents. In this sense the Agent becomes the primary arbiter of compliance, rather than the individual. This raises some interesting questions due to the fact that different Agents have varying levels of competency, and Sole Traders tend to operate in a high number, fast turnaround, low involvement job space. Consequently, as a result of this, they do not always perform the compliance check HMRC would expect.

Sole traders are primarily concerned with 'earning' and driving income through their business, tax is minor part of their regulatory/ statutory responsibilities and part of the financial running of their business. This means often very little time is devoted to compliance activities and in particular little interest is paid to HMRC or indeed other state voices. Sole Traders believe they need to know 'what to do and when to do it by' and anything else is supplementary.

## 6.5 Implications for HMRC

When assessing the findings of this research, and its implications for HMRC moving forward, it is vital that the challenges generated are both recognised and planted firmly in the equation. The concept of driving behavioural change via the role of communications cannot be solved overnight; the process is likely to be incremental and gradual, with levels of success achieved over a considerable period of time. The measuring of success – in the short, medium and long term – will very much need to take this situation into account. Any strategy must truly understand and appreciate what can feasibly be achieved at the various stages of development, and over specific periods of time. Human behaviour is a very complex area.

Two great examples of this situation are attitudes around drink driving and the wearing of seat belts. In both instances the reasons for modifying behaviour were clear (i.e. improve safety, save lives, don't break the law), both were supported by powerful government regulation and communication messages, however both took 15-20 years to successfully integrate themselves on a large scale societal level. These examples provide important case studies and a backdrop for the development of this research. It may not take 20 years to enforce large scale behavioural change amongst the UK's Sole Trader fraternity, increasing tax compliancy in the process, however it should be recognised that the process is likely to be long, drawn out and immensely challenging.

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## Appendices

### List of contents:

1. Full discussion guide
2. Sample details
3. Models of behaviour
4. Different types of networks

## Appendix 1 – Full discussion guide

### Warm up

- Introduction and explanation
- Call for frank and honest views and opinions with reassurance around confidentiality
- MRS and recording etc

### 15 mins - General overview – build personal and network profile

***This section addresses Objective 1 – to understand networks and how these work and how they are formed. It also addresses Objective 2 and explores (unprompted) how HMRC influences the network.***

Build a full picture of the respondent, their background and current personal situation so that we understand who they are and what their circumstances are. These factors are key in helping understand the macro-social economic factors (norms) that are likely to drive them as individuals. Understanding how they got where they are is key to understanding their networks, what drives them and their likely role within the networks.

### General questions

- Age
- Education
- Upbringing
- Current living arrangements
- Family situation
- Employment/ employment history
- What does business do?
- How long trading?
- Annual turnover?

Establish and explore the personal network (build a map of different contacts/ social touch-points). This will allow us to understand the reach of the network, frequency of contact points and number of contacts so that we can imply the likely impact of individuals on their networks and how messages might travel through networks. Needs to address issues of reach e.g. geography of network, number of contacts etc.

- Describe your social circle?
- How big is it?
- Who is in it?
- Frequency of contact?
- Where you live?
- Where you socialise?
- Why they socialise with different people?

- What is the purpose of different personal relationships?
- How have personal networks evolved over time?
- How have your interactions changed over time?
- How has your role in the personal network changed over time?
- Do the people you know are self employed or PAYE?

Understanding the business/ trade network will be key to establishing the role of Group norms (i.e. trade), how these intersect with personal networks and how messages travel within and across networks. Beginning with a picture of their business we will look to understand how the network works, who has most influence and why, what factors drive decision-making and the extent to which there are 'herd' behaviours (i.e. how a key influencer might influence overall network/ group behaviours). Also look at how this has changed over time to establish how current network may differ from previous experiences.

- Describe your business network?
- How has the business evolved over time?
- Tax profile. What taxes do you pay? VAT? Self assessment?
- How finances/ tax managed?
- Relationship with advisors/ Agent?
- Who else is involved in the business?
- Has this always been like that?
- Do you/ how do you network?
- Describe your network of business contacts?
- Who and why to you mix with?
- Regularity of contact?
- What are the benefits of different contacts?
- To what degree are contacts personal and business/ personal or business?
- What is the extent of cross over in your personal and business networks?
- How has your business network changed over time?
- Any major changes in the business and how these have affected you? Your network?
- Are business contacts PAYE or self employed?

*Overall this will be used to build a map of each person and business network and how these overlap/ or not? Also how this has evolved over time? It will allow us to understand the reach of networks and patterns of how they work (for different trades) and how messages/ information travels within and across networks, who are key influencers and why messages seem to resonate/ take hold.*

## **5 mins - Personal norms**

***This section addresses Objective 1 & 3 – to understand networks and how they are affected by social norms/ peer groups. Personal norms are a mitigating influence on behaviour so need to be considered to fully understand how networks and peer groups influence behaviours.***

Understanding the personal context is key to understanding the relationship between personal and social norms on how messages can/ will/ might travel within networks. Personal factors mitigate social and group norms so need to be considered as part of the overall behavioural picture.

- Explore the personality along the lines of the 'Big Five' (OCEAN) five broad factors of personality traits to build a personality profile. This will set a personality baseline which will help understand how likely individuals are to be likely to take risks/ be extrovert about experiences (e.g. evasion) etc. This will be used to add a personal dimension to our understanding of an individual and how personal, social and group norms work together to drive particular behaviours and attitudes.

Key areas of exploration:

- Attitudes to family and friends?
- Attitudes to community/ nation/ state?
- Under attitudes to state make sure explore the following:-
- What is the role of the state?
- How does state affect your business?
- Is state seen as fair especially in administration of taxes?
- Can you see link between state and provision of services e.g. tax pays for hospital beds?
- Attitudes to catching non compliant individuals/companies?
- Where do they feel they belong?
- What does identity mean for them?
- Attitudes to risk/ risky behaviours?
- Attitudes to finances/ money?
- Attitudes to planning?
- Attitudes to organisation/ importance of being organised?
- Attitudes to taking care to get things right/ accuracy?

## **20 mins - Tax, tax compliance and the role of the peer network**

***Addresses Objectives 2 & 3 explicitly and lays the groundwork to understand Objective 4. This takes the personal network understanding already built up and directly addresses the evasion/ compliance issues and how these are influenced. This is the key section that will allow us to bring together our understanding of networks and norms to build the hierarchy of compliance influencers.***

***Under this section particular***

Addressing key influences on compliance and the compliance hierarchy is tricky and much must be inferred and put in the context of the understanding built through the exploration of the networks and how these work. Here we will explore the major influences on compliance and what role their networks play in shaping attitudes and behaviours. This will allow us to explore further perceptions of opportunities to evade (where these exist/ what they are/ are not taken etc.) as well as what factors shape the decisions to actively evade tax. This section will be used to address key issues in the brief around the role of social/ group norms in influencing compliance behaviours, drawing heavily on the network maps built earlier to contextualise the understanding and answer the key objectives from the brief.

- Why do you pay tax?
- What makes you pay tax?
- How important is it to pay tax?
- Why do others pay tax?
- Probe: moral obligation, fear of punishment, social requirement?

Group norms:

- Is the individual motivated by altruism, fairness and moral attitudes to pay tax?
- Does the person see their trade as a distinct group different to others in society if so what are norms within this group?
- Does the person see self employed as a distinct group different to others in society if yes what are norms within this group?

Norm questions:

- What do you think others who do your job do? E.g. questions around paying tax, cash in hand, use of accountants?
- How does their behaviour influence/ not influence yours?
- What are the biggest influences on what you pay your tax?
- Are norms within the trade/self employed different to that of the person's social/personal friends?
- How do norms impact on business decisions (e.g. influence competition and financial pressures)?
- Do you discuss with others who you think is paying tax in your trade?
- If yes probe more about discussions

Hierarchy of norms – perceptions:

- Are there levels of non compliance seen as OK?
- When and what situations might be acceptable for not paying tax?
- Are there perceptions that other people do this i.e. within self employed, trade, social circle?

### **Propagation of messages - general introduction**

- How aware would you say you are of the tax system? What do you know?
- Do you see differences by type of tax/ duty – Income Tax, IHT, CGT, VAT, CT, Excise?

- If pay VAT, do you distinguish between VAT man and general tax man?
- What does HMRC do?
- Have you heard of them before?
- Where have you heard of them?
- What contact/advice have you had from HMRC?
- Are there any particular messages/contacts you remember? (e.g. adverts, leaflets, posters etc...)

#### Probe about particular messages

- How did hear about the message – media, word of mouth or is it implied hearsay etc?
- If word of mouth – who communicated the messages?
- What was the impact of the message?
- Why remember it?
- Did you pass on message to others and who (i.e. personal or business networks)?

#### Propagation of specific messages

- Enquire about knowledge of Name and Shame or other media messages
- If the respondent has heard of it – probe further to see how found out about it. – Directly, through media or through 3<sup>rd</sup> party? (Personal or business network)
- What was the impact of the message?
- Did they pass the message onto anyone else?

#### Enquire if know anyone who has been under audit

- If the respondent has heard of it – probe further to see how found out about it. – directly, through media or through 3<sup>rd</sup> party? (personal or business network)
- What was the impact of the messages?
- Did they pass the message onto anyone else?

#### Enquire about knowledge of penalties

- If the respondent has heard of it – probe further to see how found out about it. – directly, through media or through 3<sup>rd</sup> party? (personal or business network)
- What was the impact of the messages?
- Did they pass the message onto anyone else?

#### Enquire about general discussion/perceptions around tax deterrents

- What discussion take place around tax messages?
- What was the impact of the messages?
- Did they pass the message onto anyone else?

#### General points around networks and messages

- What factors would encourage the person to pass on / discuss HMRC messages with others?
- Who would they discuss positive messages with?
- Who would they discuss negative messages with?
- What factors discourage the person to talk about HMRC messages?

- If the intervention is likely to cause more damage (the intervention has a higher penalty) are they more likely to discuss with others. Who would they discuss this with)?

Perception of messages and impact

- How severe do you think the penalties are for getting caught?
- Are they be different for Self-employed?
- How likely is it you'll get caught/ pulled up if you don't do what you should?
- How would this happen?
- How do you think people get caught?
- Have you ever not done everything you should?

### 5 mins - Changing economy

***Explicitly addresses Objective 4 adding to understanding already built throughout the interview to allow us to see 'how things have changed over the past 18 months'. This will raise the specific question of have tougher economic times been a direct and explicit influence on compliance decision-making and how has the network played a role in this.***

Using the whole previous conversation as a baseline for behaviours, this section will explore how the past 18 months may/ may not have been different and how economic changes may have influenced behaviours to explicitly address this objective from the brief.

- Has the current economic climate affected your business?
- What changes have you seen?
- How have your friends/ fellow business owners been affected?
- What does this do to you as a tax payer?
- Is it harder to pay?
- How has this affected your business?
- Does the current economic situation affect how you think about tax?
- Does it make people more or less likely to 'fiddle on the margins'?
- What influences changing opinions on tax and the importance of getting it right at a time like this?
- What have you heard others saying?
- Do you think more people are likely to take risks with their tax? What kinds of risks?
- What's the impact of this on you?
- Is there anything that would make people more willingly compliant?
- What one thing would make the biggest difference to people paying their tax?
- Have your tax networks changed in the weakening economy
- Are you more likely to discuss tax affairs with others in the weakening economy

**Thanks, close.**



## Appendix 2 – Sample details

The research followed the SME Customer Segmentation commissioned by HMRC and as a result two sampling methods were used to recruit respondents to the research:

- The use of re-contact sample from previous HMRC SME research conducted by Quadrangle (phase 1 interviews);
- Free-found respondents using a recruitment questionnaire with attitudinal screening questions (Key Discriminating Questions) developed in the earlier compliance segmentation. The recruitment screener was conducted by telephone and respondents were invited to a face-to-face interview.

The following tables provide a breakdown of the achieved samples for phases 1-3 of the research.

**Table 3.1: Phase 1 sample profile**

Phase 1 (10 telephone interviews)	
Profile group (Potential Rule Breaker/Rule Breaker)	Industry sector
Rule Breaker	1.Driving school
	2.Building
	3.Photography
	4.Property management
Potential Rule Breakers	5.Graphic design & property development
	6.Psychotherapist
	7.Utilities
	8.Supply & distribution
	9.Taxi
	10.Financial services

**Table 3.2: Phase 2 sample profile**

Phase 2 (10 face-to-face interviews)			
Profile group (Potential Rule Breaker / Rule Breaker)	Industry sector	Location	
Rule Breakers	Electrician	Birmingham	
	Web Design		
Potential Rule Breakers	Plumbing		
	Building		
Rule Breakers	Web Design	London	
	1. Web Designer		W
	2. Web Design		W
Potential Rule Breakers	3. Web Design & Programming		W
	4. Plumbing		PI
	5. Building	B	

**Table 3.3:**
**Phase 3 sample profile**

Phase 3 (20 face-to-face interviews)		
Profile group (Potential Rule Breaker / Rule Breaker)	Industry sector	Location
Rule Breakers	1. Building & Carpentry	London
	2. Web Programming	
	3. Web Design	
	4. Electrician	
Potential Rule Breakers	5. Electrician	
	6. Electrician	
	7. Web Design	
	8. Electrician	
	9. Plumber	
	10. Web Designing/Web Programming	
	11. Web Design	
	12. Web Design	
Rule Breakers	13. Building	Birmingham
	14. IT	
	15. Building	
Potential Rule Breakers	16. Plumber	
	17. Web Design	
	18. Web Programming	
Potential Rule Breakers	19. Plumber	Nottingham
	20. Web Programming / Design / Computer Specialist	

## Appendix 3 – Models of behaviour

### A contextual overview of behavioural models used to help aid analysis

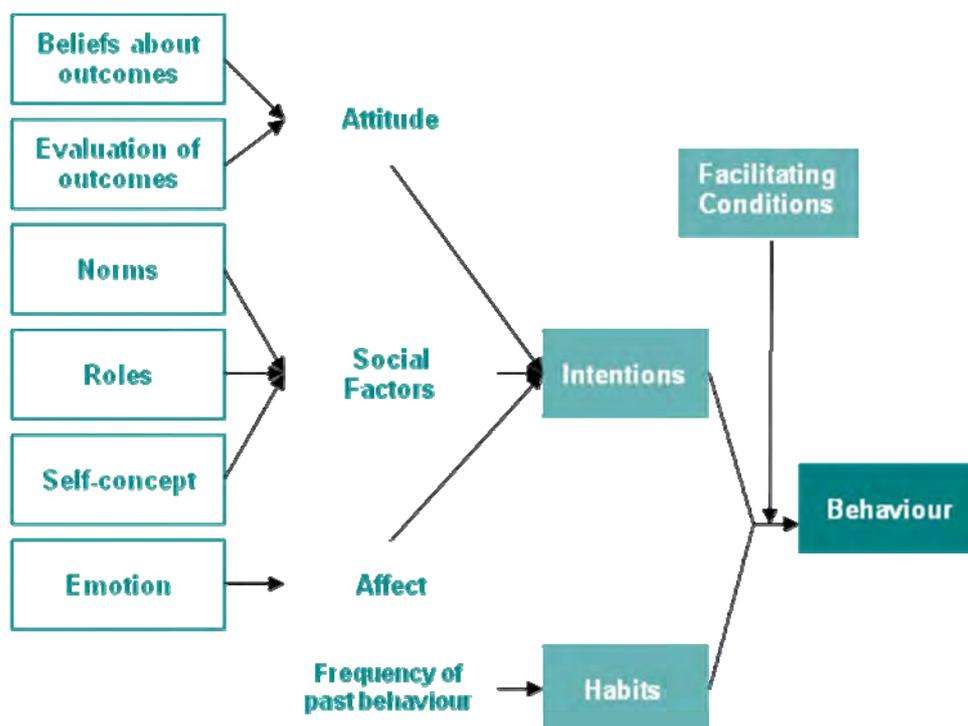
This research is essentially about an understanding of particular factors which influence an individual's behaviour and this means understanding the many different factors that influence it. The research concentrates on understanding social norms, but by way of context it is important to acknowledge the wider sphere of influence by looking at a few theoretical models which consider what influences behaviours.

A review of behaviour theories helps ensure all relevant factors for tax compliance are covered. The common factors across models that are relevant for this research are attitudes and beliefs, social norms, efficacy and agency. Efficacy and agency, although slightly different in kind, both deal with the individual's beliefs about the outcomes of any given behaviour. This is particularly relevant to tax compliance where a risk/ reward calculation is often made by the individual.

Habits and emotions are also common across models which portray behaviour as having an unintentional aspect to them. Habits and emotions are also relevant in the context of compliance, although they are less easy to influence.

Triandis' Theory of Interpersonal Behaviour (below) is a commonly used model and has many of the elements needed for a tax compliance behaviour model – attitudes, norms, habits and past experiences. Another model often considered is Ajzen's Theory of planned behaviour. Triandis' theories are widely accepted as key to much of the academic thought on understanding behaviour and behaviour change.

**Illustration 3.2 (a): Traindis' Theory of Interpersonal Behaviour (1977)**

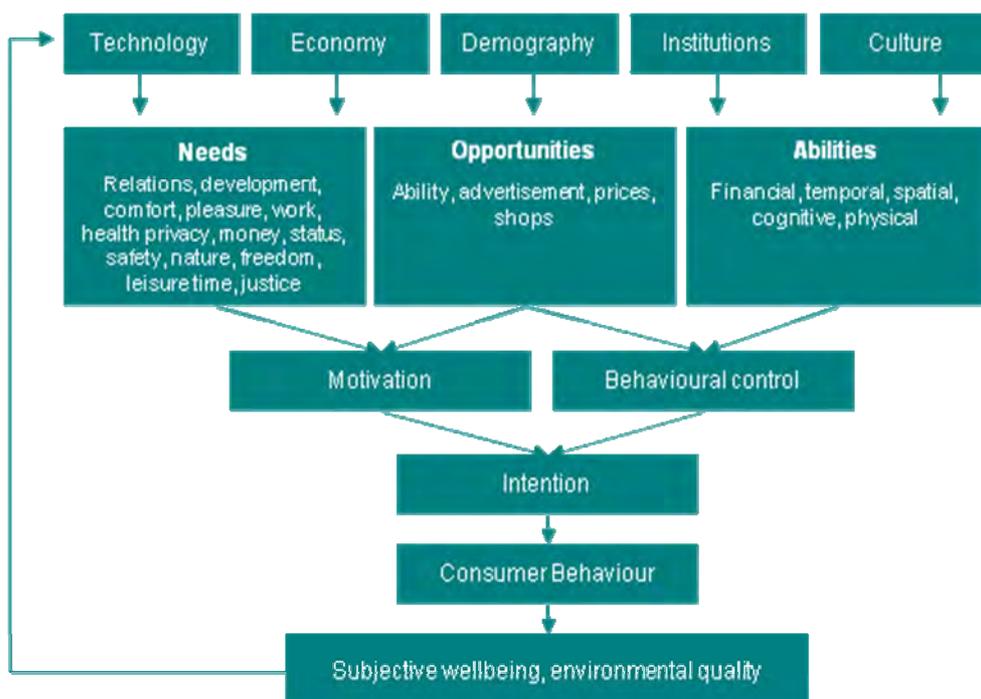


Traindis' model of behaviour is a commonly used model for understanding tax compliance as it has many of the elements needed to really understand tax compliance behaviour – attitudes, norms, habits and past experiences.

Tax compliance is also influenced by societal factors such as economy and culture – of particular interest to us as one of our key research objectives is understanding the potential impact of a weakening economy. It is important to consider models that include both societal influences and factors related to individual behaviour as these are strong influencers of behaviours and especially in times of macros-societal change (e.g. recession). These models are particularly useful for policy development where it is necessary to influence external factors limiting individuals' behavioural options, rather than simply understand how individual circumstances (e.g. upbringing, education etc) influence behaviours.

One of the best known is the Vlek et al's NOA model (1977). It is useful context when seeking to understand tax compliance as it is based on how an individual's needs, opportunities and abilities, are affected by macro-level variables, such as the economy. It then marries these societal factors with an individual's motivation and behavioural control (agency). A further important aspect of this model is that it identifies the cyclical relationship between individual behaviour and societal influences over time, which is a key dynamic in understanding longer term behavioural shifts.

**Illustration 3.2 (b):Vlek et al's Needs Opportunities Abilities (NOA) Model (1997)**



A final model that has been useful in helping frame our analysis is the Gibbons and Gerrard's 'Prototype / willingness model' (2003). This is often used to better understand why people engage in 'risky' behaviours, i.e. drug use, safety belt use, etc. and as such is relevant to guide our understanding of tax non-compliance.

In this instance, 'risk images' (the perception that something is risky and the extent of that risk) can be particularly useful for tax compliance, where the risk / reward dimension plays such a strong part in understanding behaviours. 'Risk images' also offer an opportunity to understand and measure the impact of specific interventions to determine their effects as they can be monitored before and after interventions. For example, it is possible to measure the public image of those people that cheat on their tax or the perception that evading tax is likely to result in 'punishment'.

Whilst this is not intended as a full review of academic or other theory, these three examples of behavioural theory all offer a particular insight into our understanding of what influences individuals' behaviours and how social norms play an important part in this. We have used these models as the basis for much of our analysis and they essentially form something of a frame which we can use to ensure our analyses is completed from as informed a perspective as possible.



## Appendix 4 – Different types of networks

### **Business networks** (e.g. face to face breakfast meetings, online forums)

Face to face business networks are always 'paid for' events. They represent organised, formal groups and contain individuals from different / specific areas of business. They are primarily concerned with knowledge sharing, aiming to provide leads, contacts, and business advice, with the ultimate aim of developing the business awareness and acumen of those involved. They are driven by the fact they are mutually beneficial to all involved – regardless of one's position or status within the network. Once the benefit of attending is lost, an individual will sever network involvement (however they may not cut ties with all the people involved – i.e. members who become friends or have some type of on-going business use). An important function of the network is to allow individuals to keep on top of changes and trends within the market e.g. prices, technology, financial regulation, tax issues. The principle drivers of information in this context are accountants and professional financial advisors, and this information is driven by HMRC and accountancy trade knowledge.

### **Circumstantial networks** (e.g. sports clubs, community involvement, parents)

As the name suggests these networks are driven by specific circumstances rather than any sort of business design. However their importance should not be overlooked; they are face to face and occur on quite a regular basis. Also, the often carefully crafted selection of people involved in the network (the mix of people is chosen to maximise business opportunities) makes them quite diverse, and potentially very useful. They provide the opportunity to mix with people possessing a wide range of knowledge and skill-sets, which is not always prevalent in closer, more selective, friendship groups. However, whilst some close friendships may exist within them, the level of trust is typically lower amongst these networks, so discussions around non-compliance, for example, will be less prominent.

### **Personal networks** (e.g. circle of close friends, family)

Personal networks are characterised by the length of time they take to develop, and the emotional closeness members share. The evolution of personal networks is a slow process as, to belong, a certain degree of intimacy and trust must be fostered towards an individual. Trust is the key driver within this type of network. They *will* grow and develop, however, as acquaintances (from other networks e.g. university, work) are brought into the group, and age, life-stage and geographic location start to impact on group dynamics. As trust levels are higher in these networks the probability of discussing more personal, 'high risk', subjects such as personal tax situations and non-compliance are greater, however access to experts is likely to be limited. This will potentially have an impact on the quality of information passed between the group, which could involve information regarding ways to off-set tax liabilities. Contrary to this, however, personal networks are also utilised to access more formal business support e.g. a recommendation of an accountant or IFA.