



Research report

SME Usage and Attitudes - SME Customer Segmentation

To enable HMRC to better engage SME businesses with the services we provide

Business Customer & Strategy

February 2010

About the Business Customer & Strategy (BC&S) Directorate

Business Customer & Strategy (BC&S) is part of Business Tax, and is responsible for developing HMRC's programme of SME customer research.

The goal of BC&S is to make customer understanding a reality by providing colleagues insight into our customers' attitudes, needs and behaviours. This enables HMRC to develop business tax strategies through customer understanding, so that we can design better products, processes and services which meet our customers' needs.

BC&S aims to maximise business customer compliance for HMRC at best cost for both HMRC and the customer, and so support HMRC's strategic objectives to ensure that businesses pay the right amount of tax, whilst at the same time improving customers' experience and the overall UK business environment.

Contents

Background to this research	3
Research requirements	3
The aims and objectives of the research	3
Who did the work	4
When the research took place	4
Method, Data and Tools used, Sample	4
Main Findings	5
Overview of the SME Segments	7
Validating the research	19
How this research has been used	19
Next steps	19

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Background to this research

There are over 4.8 million small and medium enterprises (SMEs) in the UK – over 99% of all businesses - together accounting for around 50% of total UK business turnover and 60% of total private sector workforce. We estimate that around 35% of total tax receipts relate to SME business activities.

Servicing this group of businesses consumes a significant proportion of HMRC's costs and resources and – as close to 90% of all administrative business burdens fall on SMEs – HMRC's strategic aims include the drive to reduce costs for compliant businesses, and improve customers' experience of dealing with the Department.

Research requirements

This research aimed to throw fresh light on HMRC's small business customers – enabling HMRC to better understand:

- the composition of this diverse population;
- the products they interact with;
- how they use our services;
- what footfall this creates for our services and products; how we could gain greater cost effectiveness in delivering our current products and services; and
- how we could develop more differentiated services tailored to the specific requirements of distinct SME segments.

Utilising this knowledge would then enable HMRC to better engage SME businesses with the services we provide, and improve our relationship with SMEs.

The aims and objectives of the research

- What is the composition of the SME customer base?
- What proportion of SMEs deal with the four main families of tax products?
 - Income Tax Self Assessment (ITSA)
 - VAT
 - Corporation Tax (CT) and
 - Payroll taxes (PAYE & NICs)
- Whether businesses choose to use an agent / intermediary (for example, an accountant or book-keeper) when they engage with us?
- What parts of a customer's obligations are met through a third party; and what are done directly?
- What are the key attitudes towards compliance? How does this differ by SME type? How does this translate into behaviour?

Who did the work

The research was conducted by Quadrangle, an external research agency.

When the research took place

Phase 1: January and February 2009.

Phase 2: October 2009.

Phase 3: May 2010.

Method, Data and Tools used, Sample

Phase 1 involved initial quantitative segmentation research and analysis (using CHAID).

1,468 30 minute interviews were undertaken with a representative sample of UK SMEs to develop a compliance-based segmentation of SME businesses, based on 6 core dimensions (see page 5 for details).

This enabled us to develop a market representative view of SMEs' interactions with HMRC and their attitudes towards fulfilling their legal obligations for each of the tax regimes.

Phase 2 involved deeper qualitative understanding and validation (using discriminate analysis) to add colour to the emerging segmentation model established in Phase 1.

Fourteen 90 minute focus groups (2 for each of the 7 SME segments) were held in London, Manchester, Birmingham and Nottingham, the outcomes of which enabled us to establish:

- segment personas to bring the quantitative profiles to life; and
- a contextual understanding of SMEs' attitudes, and how they differ across the segments.

The outcomes of this research were then rigorously cross-checked against HMRC's internal proprietary data sources to ensure a consistency in results.

Phase 3 saw the provision of a final report and a SME segmentation film.

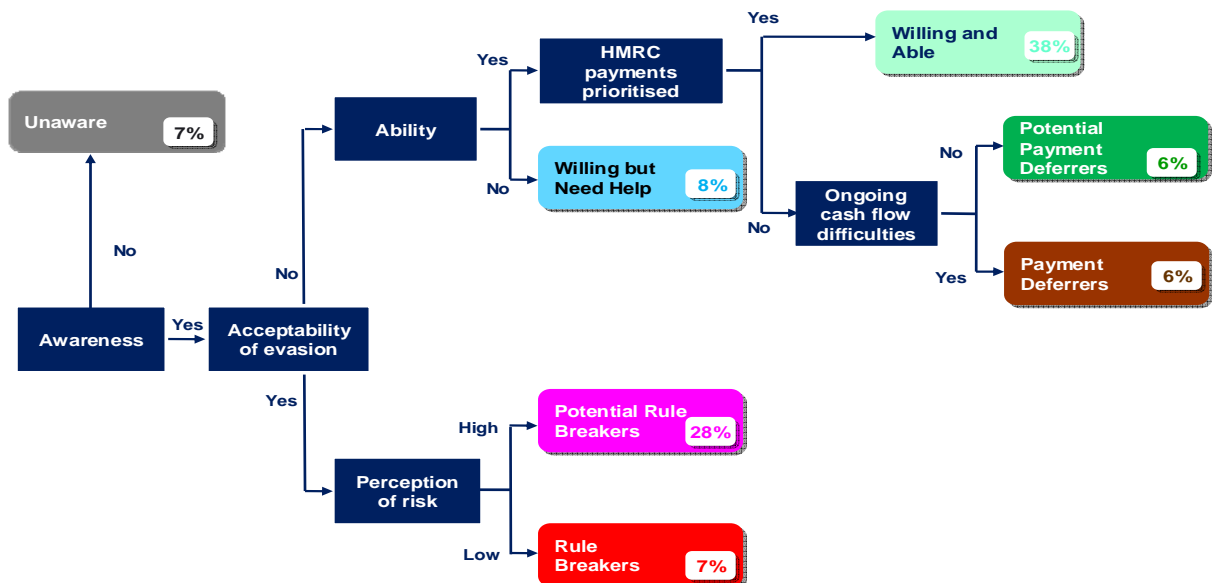
Main Findings

The segmentation survey was based on 6 core dimensions (*the blue boxes in the diagram below*):

- Awareness
- Acceptability of evasion
- Perception of risk
- Ability
- HMRC payments prioritised
- Ongoing cash-flow difficulties.

Analysis of the response data enabled us to develop the following segmentation model comprising 7 discrete SME customer segments:

- Unaware
- Willing But Need Help
- Willing and Able
- Potential Payment Deferrers
- Payment Deferrers
- Potential Rule Breakers
- Rule Breakers



NB: This segmentation model does not take account of any business operating in the informal or hidden economy (as they did not feature in the initial quantitative research).

The segmentation model was built by stepping through the dimensions as follows:

1 - Awareness

Businesses who were not aware of HMRC's remit, nor what they needed to do to meet their obligations to HMRC, are classified as **Unaware**.

2 - Acceptability of evasion

Businesses passing the awareness ‘test’ were tested on whether they were pre-disposed towards evasion - i.e. that it was ok for them to evade taxes, and that other businesses felt the same way too.

3 - Perception of risk

Of those SMEs that felt evasion was both more commonplace and acceptable than is actually the case, those who felt the chances of getting caught and punished were low, were believed likely to break the rules and hence were classified as **Rule Breakers**.

Those who held a higher expectation of being caught and punished, were believed less likely to break the rules, and so were classified as **Potential Rule Breakers**.

4 - Ability

For those SMEs that viewed evasion as unacceptable, we checked whether they had the necessary skills and ability to meet their obligations to HMRC. Those who indicated low levels of ability, and were therefore less likely to get their tax right, were classified as **Willing but Need Help**.

Those businesses who found evasion unacceptable, and who ‘passed’ the ability test, were viewed as being more likely to be able to meet their obligations. These provided the pool of the final three segments in the model.

5 - HMRC payments prioritised

Those businesses that demonstrated a willingness to comply as well as the ability to do so, were asked if they would prioritise payments to HMRC over payments to others that they owed – e.g. suppliers and staff. Those that stated they would pay HMRC before paying others were classified as **Willing and Able**.

6 - Ongoing financial difficulties

For those businesses which, when faced with financial difficulties, would be more pragmatic about paying their taxes and would potentially defer payments to HMRC, we applied a final test.

Those businesses that were likely to de-prioritise and defer payments to HMRC, and had a track record of instability and current cash flow problems were classified as **Payment Deferrers**.

Those businesses that would de-prioritise and defer payments to HMRC but were not in current financial difficulties were classified as **Potential Payment Deferrers**.

NB: The segments represent SME customers’ predominant attitudinal characteristics, and should not be read as an absolute reflection of actual customer behaviours.

Overview of the SME Segments

Unaware - 7% of SMEs

Key Demographic Tendencies	Sample Average
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SME Compliance Segmentation

Sole Traders	78%	74%
1 to 4 employees	16%	17%
Under £60k turnover	70%	57%
Trading for less than 2 years	39%	25%
Trading for more than 11 years	34%	42%
Using an agent	60%	72%
Tax type		
Corporation Tax	38%	33%
Employer (PAYE)	33%	34%
Self Assessment	78%	79%
VAT	32%	50%
Don't know what taxes are dealt with	11%	1%
Compliance		
Low ability	62%	22%
Previous late payment	16%	28%

NB: This report features a series of tables. Where tables indicate figures highlighted in green, this represents where the segment in question indexes (i.e. is significant) above the average for all segments. Conversely, figures shown in red indicate significant under-indexing.

More Likely To Be:

- Confused, nervous and insecure
- Unconfident and daunted
- Inexperienced or unwilling to learn
- Beginners in transition
- Try to do things themselves

Overview

- 7% of SME businesses are united by a basic lack of awareness and understanding, coupled with low engagement. They tend to be smaller concerns.
- Unaware SMEs try to limit their Agent usage, preferring to do things themselves or rely on friends and family, in part to help reduce costs. This lack of knowledgeable representation often acts as a barrier to assimilating 'good' behaviours and practices.
- Where businesses do use an Agent it is to ensure they meet their obligations to HMRC.
- Within this segment attitudes are seen to differ between newer (trading less than 2 years) and, surprisingly, some older (trading more than 11 years) businesses.
- Newer businesses may lack knowledge and confidence now, but over time may 'transition' to other segments. The lack of engagement and confidence in older businesses is, however, more deep-rooted. They are harder to migrate, and are more likely to remain Unaware.

Awareness

- Newer Unaware SMEs may grasp some of the basics regarding their tax obligations, but they lack the necessary understanding to enable them to do what they need to do. They are more likely to seek out information, using a range of sources - friends, family, HMRC or web resources.

- Older Unaware SMEs know just enough about their tax obligations to get by - although this is often more by luck than judgement. However, they tend not to be interested in developing their awareness any further, and so are harder to reach.

Ability

- It is thought most Unaware start-ups want to get things right, but lack the requisite know-how to do so.
- Older businesses are more likely to hold a 'suck it and see' approach to tax, believing that HMRC will tell them if something goes wrong.

Motivation to comply

- Newer Unaware businesses tend to see evasion as unacceptable.
- As more of the more established SMEs in this segment indicate they would work cash in hand, older businesses are more likely to think evasion is acceptable.

Relationship with HMRC

- Whilst Unaware Start-Ups feel daunted or even afraid of tax, most feel HMRC is fairly approachable. The telephone is the preferred contact channel.
- Older Unaware businesses, however, avoid contact with HMRC, relying instead on assumptions and outdated knowledge rather than seeking out information.

Willing but Need Help - 8% of SMEs

Key Demographic Tendencies		Sample Average
Sole Traders	71%	74%
1 to 4 employees	22%	17%
Under £60k turnover	40%	57%
£60k to £150k turnover	43%	27%
Trading for less than 2 years	28%	25%
Trading for more than 11 years	48%	42%
Using an agent	84%	72%
Tax Type		
Corporation Tax	37%	33%
Employer (PAYE)	51%	34%
Self Assessment	77%	79%
VAT	66%	50%
Excise Duties	13%	8%
Compliance		
Low ability	100%	22%
Previous late payment	40%	28%

More Likely To Be:

- Businesses that have at some point experienced trouble with HMRC
- In need of help to comply
- Daunted, and users of Agents

- Unwilling to learn
- Confused, wanting HMRC to simplify processes

Overview

- These customers account for 8% of SMEs.
- These SMEs are typically through their first few years of trading, and exhibit established levels of turnover and number of employees.
- Whilst these businesses want to comply, they are hindered by their low levels of ability and confidence.
- They see tax obligations as an administrative burden and cost rather than as a core business priority, and are overly reliant on Agents.
- However, whilst Willing but Need Help SMEs are often frustrated by their own shortcomings, they tend to lack the time, and/or the desire, to enhance their own practical abilities any further.

Awareness

- Willing but Need Help businesses are generally aware of *what* they need to do, but not *how* to do it.
- These SMEs are resistant to finding out more and lack confidence to take control of their tax.
- Willing but Need Help businesses exhibit a fear of the unknown and the potential repercussions from any mistakes they make.
- They are familiar with the information sources and channels open to them, but they hesitate to contact HMRC, tending to seek advice and assistance from others. They have one of the lowest levels of website usage.

Ability

- They often find tax procedures and processes too difficult to understand.
- A lack of specialist financial skills or resources means Willing but Needs Help businesses rely heavily on Agents, trusting them to ensure that the business is within the rules whilst not overpaying tax.

Motivation to comply

- Willing but Needs Help SMEs think evasion is unacceptable, and are unlikely to push boundaries (e.g. taking risks to reduce their tax liability), let alone cheat.
- These businesses feel evasion is commonplace and support HMRC's compliance activities as means to ensure fair administration of the system.
- They are proud of their compliance track record (even though they may be ignorant of the errors they may be making), and want to be recognised for their efforts to comply, rather than be penalised for occasional mistakes.

Relationship with HMRC

- Willing but Need Help businesses see HMRC as complex, bureaucratic and difficult to deal with (although this may be a perception rather than reality as where they have direct dealings with HMRC, they often find the Department to be supportive).
- These businesses demonstrate a hesitancy to contact HMRC, hence their propensity to seek assurance via their Agents.
- Where they do contact us, most would prefer to use the phone - although this segment is more likely than any other to seek face-to-face contact with HMRC.
- These SMEs feel the relationship with the Department is a bit one-sided, with undue pressure placed on SMEs to assist in the tax collection process, creating unwanted and unwarranted costs.

Willing and Able - 38% of SMEs

Key Demographic Tendencies		Sample Average
Sole Traders	76%	74%
1 to 4 employees	16%	17%
Under £60k turnover	59%	57%
£60k to £150k turnover	27%	27%
Trading for less than 2 years	24%	25%
Trading for 11 years or more	41%	42%
Using an agent	62%	72%
Tax Type		
Corporation Tax	34%	33%
Employer (PAYE)	34%	34%
Self Assessment	79%	79%
VAT	48%	50%
Compliance		
Low ability	0%	22%
Previous late payment	16%	28%

More Likely To Be:

- Staunchly compliant
- Confident and capable
- Sticklers for the rules
- Active and effective record keepers, with effective systems in place
- Good financial managers

Overview

- The largest of all segments, Willing and Able businesses account for 38% of SMEs.
- Given the size of this segment, businesses here most closely represent the sample average for all segments.
- Willing and Able SMEs tend to be smaller-sized, quite long-standing businesses, and (like other segments) sole traders in the main.
- Willing and Able SMEs are considerably more compliant than other segments, believing that evasion is completely unacceptable, and relatively uncommon.

Awareness

- They are aware of what they need to do, and feel sufficiently equipped to meet their obligations to HMRC.
- Willing and Able SMEs understand and support HMRC's role in collecting taxes, and believe paying taxes is fundamentally part and parcel of running a business. These SMEs believe it is their responsibility to keep on top of their tax obligations.
- These businesses are proactive in building their own knowledge, and seek a strong relationship with HMRC. They use a variety of information channels to keep up to date – with many having used the HMRC website for advice.
- They are less likely to use an Agent, but where they do it's to primarily oversee the business' own calculations and for guidance on non-standard or specialist issues.

Ability

- Willing and Able SMEs are confident and capable of fulfilling all the basic requirements of tax compliance, and getting their tax right.
- They are good organisers, having internal processes and systems to ensure they keep on top of their tax, and keep their business records up to date. They recognise the importance of being prepared.
- Being competent financial managers, Willing and Able SMEs are more likely to retain more finance work in-house, using Agents to ensure the business gets their tax right first time.
- Agents tend to play a more prominent role in larger Willing and Able businesses, providing guidance on more complex issues (e.g. checking Corporation Tax computations).
- Willing and Able SMEs are not immune from error-making, but learn from these mistakes to ensure improved future compliance.

Motivation to comply

- For this segment, keeping on the right side of the law is essential. Willing and Able businesses believe that evasion is quite rare, and that it is unacceptable – being both morally and legally wrong.
- These businesses believe that SMEs who systematically break the rules should feel the full force of the law. Willing and Able businesses want HMRC to actively pursue cheats and make sure they are penalised, to ensure the system is fair to those who do comply.
- However, whilst evasion is illegal, these businesses are prudent by nature, meaning some are happy to use their more advanced knowledge of the tax system – typically on the advice from an Agent - to keep tax to a (legal) minimum.
- Paying tax in full and on time is seen as a key responsibility of owning a business, so these SMEs tend to prioritise tax payments over those to staff and suppliers (with PAYE and VAT prioritised as the most important taxes to pay).

Relationship with HMRC

- Willing and Able SMEs have a higher degree of respect for HMRC, and unlike other segments do not feel persecuted or victimised by HMRC.
- They seek a close relationship with HMRC and want the Department to have a positive view of their business.
- These businesses feel that their good house-keeping and compliance track record helps their standing with HMRC.
- They value flexibility in their dealings with HMRC, and recognition for their efforts to comply.
- Like most other segments, Willing and Able SMEs prefer to use the phone to contact HMRC, and although nearly two thirds of this segment have used the HMRC website, these SMEs are more likely than other segments to make general enquiries in writing.

Potential Payment Deferrers - 6% of SMEs

Key Demographic Tendencies	Sample Average
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SME Compliance Segmentation

Sole Traders	54%	74%
5 to 24 employees	16%	7%
Over 25 employees	4%	1%
Under £60k turnover	29%	57%
£60k to £150k turnover	34%	27%
Over £150k turnover	38%	17%
Trading for less than 2 years	21%	25%
Trading for 5 years or more	70%	62%
Using an agent	70%	72%
Tax Type		
Corporation Tax	46%	33%
Employer (PAYE)	46%	34%
Self Assessment	61%	79%
VAT	64%	50%
Compliance		
Low ability	0%	22%
Previous late payment	34%	28%

More Likely To Be:

- Motivated to comply
- Confident, with capable systems in place
- Financially pragmatic and stable
- Larger and successful
- Businesses with a consistently positive cash-flow

Overview

- Potential Payment Deferrers make up 6% of the population.
- These tend to be larger and more successful SMEs, and are more likely than other segments to be registered for Corporation Tax.
- They actively seek to comply with tax obligations, believing evasion is unacceptable.
- What distinguishes these SMEs from Willing and Able businesses is that they would defer payments to HMRC if financial circumstances dictated. However, at present there is no need to do so because they tend to enjoy a consistently positive cash-flow - although this is being squeezed in the current economic climate.

Awareness

- Tending to be quite experienced businesses, Potential Payment Deferrers are quite aware of their obligations in respect of the tax system, holding a good knowledge of the taxes they deal with.
- They demonstrate a slightly lower than average use of Agents, being more self-sufficient and retaining more financial resources in-house than other segments – resulting in them preparing and sending in many returns themselves without the need for Agent involvement.
- Potential Payment Deferrers regularly use the HMRC website and tools, as well as Businesslink.gov and SME representative organisations.

Ability

- Potential Payment Deferrers have larger internal financial teams than other segments.

- They have a good financial awareness and appreciation, and a good knowledge of the taxes they deal with. They are more likely than other segments to be self-sufficient in preparing and sending in returns themselves.
- These SMEs demonstrate a slightly lower than average use of Agents, and are more selective in their use of an Agent – being far less likely than other segments to use the same Agent for all their requirements.
- Potential Payment Deferrers use a variety of means to keep up-to-date with their obligations – their own internal resources, HMRC website tools (e.g. the Employers CD-ROM), Businesslink.gov.uk and other support organisations.

Motivation to comply

- Potential Payment Deferrers actively seek to comply with their tax obligations.
- Although motivated to comply, Potential Payment Deferrers are primarily focussed on managing their business, and hold more pragmatic attitudes to paying HMRC first than Willing and Able SMEs.
- This financial pragmatism means these SMEs would look to limit their tax liabilities to what is firmly within the law.
- Even though they are not at present in pressing financial circumstances, Potential Payment Deferrers would pay others (e.g. staff or key suppliers) before HMRC if financial circumstances dictated. If this were to happen, these SMEs do not necessarily view deferring payments to HMRC as non-compliant behaviour – and whilst they will incur a penalty for late payment, they perceive they are unlikely to suffer any other consequences.

Relationship with HMRC

- Potential Payment Deferrers understand the importance of meeting their tax obligations, and believe HMRC has a valid job in pursuing Rule Breakers.
- These SMEs want to be in a dialogue with HMRC, if not a relationship as such.
- They tend to contact HMRC slightly more than average, preferring to use the phone, although they often rely upon written contact.
- These SMEs think that mutual respect and openness are desirable characteristics, and this segment would look to HMRC to demonstrate these traits.
- Potential Payment Deferrers think HMRC is much more accommodating than it was 5-10 years ago, and that the Department has made things easier to deal with.
- Potential Payment Deferrers perceive HMRC as quite a joined-up organisation.

Payment Deferrers - 6% of SMEs

Key Demographic Tendencies		Sample Average
Sole traders	73%	74%
5 to 24 employees	12%	7%
Over 25 employees	2%	1%
Under £60k turnover	46%	57%
£60k to £150k turnover	34%	27%
Over £150k turnover	20%	17%
Trading for less than 1 year	16%	8%
Trading for 2 to 5 years	21%	13%
Trading for 11 years or more	33%	42%
Using an agent	87%	72%

Tax Type		
Corporation Tax	42%	33%
Employer (PAYE)	32%	34%
Self Assessment	69%	79%
VAT	61%	50%
Excise duties	19%	8%
Compliance		
Low ability	0%	22%
Previous late payment	76%	28%

More Likely To Be:

- Motivated to comply
- Facing financial difficulties
- Juggling priorities and struggling to pay
- Financially pragmatic
- Understanding and accepting of penalties
- IT savvy, open to online channels

Overview

- Payment Deferrers make up 6% of the SME population.
- They share similar characteristics with Potential Payment Deferrers, demonstrating a high level of motivation to comply with their tax obligations.
- Payment Deferrers also exhibit very pragmatic attitudes towards making payments in trying circumstances.
- What distinguishes this segment from Potential Payment Deferrers is that these businesses are far more likely to be facing real financial difficulties - forcing them to juggle current payment priorities. As a result, they are likely to be deprioritising payments to HMRC, doing so in the knowledge they will likely suffer penalties as a consequence.
- Payment Deferrers feel stressed by their situation.

Awareness

- Payment Deferrers are aware of what is needed to meet their obligations to HMRC.
- They have a good level of overall financial awareness, and understand the implications of late filing and/or payment – seeing resultant penalties as an operational cost of running their business in trying times.
- These businesses keep up to date through their own internal resources and their Agents, and are aware of what support is available from HMRC.

Ability

- Despite their financial difficulties, Payment Deferrers are capable administrators.
- They have some internal financial resource, and look to keep some tasks in-house (e.g. VAT).
- However, Payment Deferrers also demonstrate a high usage of Agents. They are selective in what they ask the Agents to do, although a priority seems to be to ensure the business can minimise what it legitimately needs to pay.

Motivation to comply

- Payment Deferrers are the least likely to feel tax evasion is either acceptable or commonplace.
- They are motivated to comply, and think it is unacceptable to cheat on their taxes, make underpayments or over-represent the cost of sales.
- These businesses think that taking compliance risks when the business is already struggling to pay would put an unnecessary additional stress on the business.
- Although they are delaying payments to HMRC, Payment Deferrers do not think of themselves as cheats (and would resent being labelled as such), believing that they are driven to make a pragmatic decision to pay late because of current cash-flow difficulties.

Relationship with HMRC

- Although actively engaged in a dialogue with HMRC, Payment Deferrers feel that the relationship with the Department is somewhat one-sided, and that HMRC does not fully comprehend or empathise with their situation.
- Whilst they receive regular contact from HMRC – and are as such used to dealing with the Department – they contact HMRC slightly less than the average for all segments.
- Payment Deferrers feel that the system could be more lenient to businesses that are facing financial difficulties, and believe HMRC could do more to help small businesses in general, especially in the current economic climate.

Potential Rule Breakers - 28% of SMEs

Key Demographic Tendencies		Sample Average
Sole traders	77%	74%
1 to 4 employees	16%	17%
Under £60k turnover	66%	57%
Over £150k turnover	10%	17%
Trading for less than 1 year	15%	8%
Trading for 11 years or more	43%	42%
Using an agent	78%	72%
Tax Type		
Corporation Tax	23%	33%
Employer (PAYE)	25%	34%
Self Assessment	85%	79%
VAT	44%	50%
Compliance		
Low ability	26%	22%
Previous late payment	30%	28%

More Likely To Be:

- Resentful of paying tax
- Using every means to legally reduce their tax bill
- Boundary pushers (e.g. taking risks to reduce their tax liability)
- Concerned they will be caught cheating

Overview

- Potential Rule Breakers are the second largest segment, making up 28% of SMEs.
- They tend to be smaller businesses, with a higher than average number of sole traders (and the joint highest concentration of customers who deal with Self-Assessment), and with many businesses in their first year of trading.
- Potential Rule Breakers feel it is normal to 'legally' avoid paying tax, and are happy to justify this, often seeking to exploit ambiguities to legally limit their liabilities.
- The fear of being caught and punished restricts Potential Rule Breakers' natural inclination to evade tax.

Awareness

- Potential Rule Breakers are aware of their tax obligations, and often have established systems and processes for managing their finances.
- They believe that tax inspections are common and this possibility – combined with their much higher perception of risk - helps keep them from breaking the rules.
- However, Potential Rule Breakers are aware that 'grey areas' exist, and are comfortable in 'legally' exploiting such opportunities – although they see themselves as law-abiding businesses because they keep on the right side of the line.

Ability

- Potential Rule Breakers take finances seriously, and are generally confident in their ability to understand tax obligations.
- However, they tend to use an Agent when confronted with new or unfamiliar requirements in order to ensure they do not pay more than they have to.
- Potential Rule Breakers are more likely than most to prepare returns themselves and then have their Agent check them before they are sent off.
- They tend to choose an Agent to enhance their familiarity with tax and help them limit their liabilities where possible. The Agent also acts to safeguard against the Potential Rule Breakers' inclination to go too far and engage in any obviously evasive practices.

Motivation to comply

- Potential Rule Breakers are more likely than other segments in believing tax evasion is more acceptable and commonplace than it really is, and these combine to mean they demonstrate a low motivation to comply with their tax obligations.
- However, they perceive the risks of being caught and punished are high, which keeps them from evading – even though they resent paying more than they have to.
- Instead Potential Rule Breakers look to exploit areas with a greater degree of flexibility – and they are over twice as likely as average to take risks with their tax.
- Although cash-flow may contribute, such risky behaviours are fundamentally driven by a desire for the business not to have to pay any more than it needs to.

Relationship with HMRC

- Potential Rule Breakers have very little trust for HMRC, and so tend to adopt an adversarial approach to their dealings with the Department.
- They often feel the outcome of contact with HMRC is pre-determined, and they expect all decisions to go against them.
- Potential Rule Breakers do not want to draw attention to themselves, and often use an Agent to advise them on the system, rather than go direct to HMRC.
- That said, this segment has above average contact with HMRC - being more than likely than any other segment to seek face-to-face contact with the Department.

Rule Breakers - 7% of SMEs

Key Demographic Tendencies		Sample Average
Sole traders	72%	74%
Over 5 employees	8%	8%
Under £60k turnover	51%	57%
£150k to £500k turnover	22%	10%
Over £500k turnover	2%	7%
Trading for less than 1 year	4%	8%
Trading for 11 years or more	49%	42%
Using an agent	95%	72%
Tax Type		
Corporation Tax	35%	33%
Employer (PAYE)	36%	34%
Self Assessment	85%	79%
VAT	58%	50%
Construction Industry Scheme	19%	6%
Compliance		
Low ability	33%	22%
Previous late payment	45%	28%

More Likely To Be:

- Entrepreneurial
- Risk-takers lacking due care
- Looking for ways around the system
- Unaware of penalties
- Using an Agent to try and *appear* compliant

Overview

- Rule Breakers account for 7% of the SME population.
- They represent fairly well established businesses – few are in their first year of trading, and this segment reflects the highest concentration of businesses that have been trading for more than 11 years.
- This established standing is also demonstrated by the Rule Breakers segment sharing the highest concentration of businesses with a turnover of between £150,000 and £500,000.
- Rule Breakers are highly entrepreneurial, and are inherent risk-takers who are looking for ways around the system – they are comfortable with breaking the rules, and not only accepting tax evasion, but actively practicing it.

Awareness

- Rule Breakers are aware of the role of HMRC, and what the Department expects businesses to do.
- However, whilst being aware of what they need to do to meet their tax obligations, Rule Breakers are not motivated to comply with them.
- They know HMRC is trying to catch them, but they feel they can stay ‘below the radar’ and not get caught. They are calculated in what they do and have a plan for avoiding discovery.

- Even if they are caught, Rule Breakers are likely to accept the fine or punishment as they believe the rewards outweigh the risks – regarding the penalties HMRC imposes as insufficient to deter them from regularly evading their taxes.

Ability

- Confident and able, Rule Breakers know enough about the tax system to navigate successfully through the areas in which they operate most frequently.
- Rule Breakers have established systems and processes, they know the rules and can manage what their business does, and does not, declare.
- They keep sufficiently on top of their affairs so that they have a plausible answer if questions were ever asked.
- Rule Breakers have the highest levels of Agent usage of all segments, viewing them as being central to maintain the success of the business. Use of Agents seems to be more selective, with Rule Breakers being more likely than average to use specialist Agents for the different taxes.
- Agents are used to minimise the business' tax liabilities, and to promote a perception of respectability, to help the business stay off of HMRC's radar.

Motivation to comply

- Rule Breakers believe cheating is quite commonplace, and partial disclosures are quite normal and something that businesses do to get the best deal for themselves – indeed, they see small-scale evasion as good business practice and a demonstration of sound commercial realism.
- Rule Breakers feel there is a low chance of being caught cheating. They do not fear penalties, and the degree of their non-compliance is often framed upon what they can afford to repay if caught and penalised.
- However, Rule Breakers do not fail to pay any tax – they do pay some, but not on all income (streams). They often make calculated assessments of what they can get away with - adopting clear payment prioritisation practices – for example payment of VAT and Employer Taxes is often put ahead of payment of Corporation Tax.
- Rule Breakers are twice as likely as other segments to have had previous investigations.
- Other forms of non-compliance are also demonstrated – Rule Breakers are three times more likely than average to work cash in hand, and six times more likely than average to fail to declare small amounts of income as they feel HMRC are unlikely to detect such income.

Relationship with HMRC

- Rule Breakers are resentful, and feel that SMEs are an easy target for HMRC as they lack the financial clout of larger companies.
- Rule Breakers do not see HMRC as a fair arbiter of the system, believing the Department exists to collect as much tax as it can.
- This overt distrust of HMRC means Rule Breakers seek to keep their relationship with the Department on their own terms.
- However, they do not avoid contact with HMRC. Rule Breakers have the highest contact rate of all segments, which may suggest that they are gleaning knowledge and testing their understanding of the rules.
- Rule Breakers perceive that HMRC is not joined-up, and perceive there to be differing risks associated with the different tax regimes. HMRC is seen as an under-resourced 'Big Brother' which, whilst it is always on the look-out to catch cheats, simply cannot check every business' records.

Validating the research

We are confident that the results of the SME segmentation model are comparable to actual taxpayer behaviour, as we compared the research findings to the results of the Department's 'Random Enquiry' programme - one of the key ways by which HMRC measures the tax gap. This comparison indicated that both sets of data identified similar customer populations for compliant traders (i.e. the willing and able), those making errors (needing help), and instances of evasion (rule breakers).

How this research has been used

HMRC seeks to put customer understanding at the heart of all of our activities - using our in-depth customer insight to structure our approach to compliance to meet SMEs' attitudes, needs and behaviours.

Increasingly this is helping the Department identify the services and interventions it needs to make to influence each customer segment, to ensure we meet our strategic objectives to increase additional revenues, improve customer experience, and drive down costs.

This SME segmentation model has been used as the basis of the development of our SME Strategy, and provided a large part of the underpinning framework for HMRC's Customer-Centric Business Strategy, and the outcomes of the 2010 Spending Review.

Evidencing our commitment to supporting private sector recovery - allowing businesses to generate growth, create jobs and make a significant contribution to the public finances - HMRC has developed an approach that explicitly supports growth in two ways, by reducing administrative burdens, while levelling the playing field by tackling tax evasion.

Centring this approach around key customer segments, our strategic approach for the next four years aims to make it as easy as possible for SMEs who are willing and able to manage their tax affairs and pay the tax that is due, whilst providing additional help for those customers that need it. Wherever possible we want to support customers to get their tax right quickly, easily and cheaply.

However, we recognise that dishonest businesses make it harder for the honest majority to compete in a challenging business environment, and in discharging our duty to collect the tax that is due, we will deter those who are tempted to evade and relentlessly pursue those who break the rules.

Next steps

To ensure the Department maintains an up to date awareness of any shifts in the SME segmentation model, HMRC undertakes to monitor segment sizes twice a year through the HMRC (SME) Customer Survey. We are also exploring research to move this learning forward and to differentiate segments through the complimentary lenses of segment prediction and segment shift – in order to continuously tailor initiatives and messages distinct to SME sub groups.

HMRC is also committed to ensuring the SME attitudinal-based segmentation model accurately reflects current thinking, and will update this analysis in the next few years.