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# Behaviours and experiences in relation to VAT registration

**Final report**

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## Glossary

Annual Accounting scheme	A VAT support scheme offered by HMRC which allows businesses to account for VAT by paying in instalments. At the end of the year an annual VAT return is sent with any balance outstanding
Business-to-business	Businesses that make most (i.e. more than 60%) of their sales to other VAT registered businesses
Business-to-consumer	Businesses that make most (i.e. more than 60%) of their sales to unregistered businesses and consumers
Cash Accounting scheme	A VAT support scheme offered by HMRC which allows businesses to account for VAT on the basis of payments received and made instead of on tax invoices issued and received
Deregistration	When a business's VAT registration is cancelled
Flat Rate scheme	A VAT support scheme offered by HMRC which simplifies accounting by allowing businesses to pay a single percentage of their total sales to HMRC as VAT instead of paying different percentages for different goods and/or services sold
Input costs	Total cost of purchasing goods and services from other businesses
Mandatory registered	Businesses whose turnover exceeded the VAT threshold but was below £150,000 when registering in 2013/14 and 2014/15
Micro business	A business with one to four employees
Nano business	A business with no employees
Unregistered borderline businesses	Businesses that are not registered for VAT and whose turnover was up to £7,000 below the VAT threshold in 2012/13 and 2013/14
VAT stagger	The points of the year when the business pays its VAT. Normally this tax period starts in January, February or March and businesses usually pay on a quarterly basis from that point (i.e. every 3 months)
Voluntarily registered	Businesses whose turnover was below the VAT threshold when registering in 2013/14 and 2014/15

# 1 Executive summary

HM Revenue and Customs commissioned Ipsos MORI to conduct quantitative and qualitative research into business behaviours and experiences associated with VAT registration. The research consisted of a telephone survey of 2,009 businesses, followed by qualitative research with 40 businesses who agreed to be re-contacted.

**VAT registered businesses were more likely than unregistered borderline businesses to make most (i.e. more than 60%) of their sales to other VAT registered businesses**, and this was even higher among voluntary registered businesses. In contrast, the majority of unregistered borderline businesses make most of their sales to consumers or unregistered businesses.

**Accountants were the most common source of advice on VAT** (67% of registered businesses got information from an accountant when deciding to register and 57% of unregistered borderline businesses have sought information on VAT from an accountant). The second most common source was HMRC (14% of VAT registered businesses and 11% of unregistered borderline businesses), with at least nine in ten of each group finding the advice useful. The qualitative research suggests businesses found the VAT sections of the gov.uk website helpful, but experience of the helpline was more mixed.

VAT registered businesses were asked about **awareness of different aspects of VAT**. Awareness was very high across most aspects, including the need to submit accurate returns on time, the ability to claim back VAT and the requirement of additional record keeping. Awareness among unregistered borderline businesses was mixed. While most claimed to know that businesses should register for VAT once their sales are above a certain threshold, just over a quarter (28%) could give the current VAT threshold. Around a quarter were not aware that businesses can reclaim VAT. The greatest uncertainty was about whether VAT is only due once an invoice is issued and if customers based overseas need to be charged VAT. The research suggests that levels of awareness were closely linked to prior experience of VAT.

The **most common unprompted reason given for registering for VAT by voluntary registered businesses is the expectation of reaching the threshold soon** (26%), followed by agent advice (20%) and the ability to reclaim VAT (13%). The qualitative research revealed some businesses viewed voluntary registration as a precautionary measure – they expected to grow and did not want to risk being in breach of regulations. Most mandatory registered businesses said exceeding the threshold was the main reason they registered (67%).

Having registered, the **main benefit was seen as reclaiming VAT** (mentioned by 33% of voluntary registered and 27% of mandatory registered without prompting). This was followed by improved reputation or credibility (20% and 12% respectively). Overall around three in ten said they have not experienced any benefits, with mandatory registered more likely to say this (39% compared to 24% voluntary registered). However, after prompting, more businesses agree than disagree that being registered is good for their business and that other VAT registered businesses are more likely to do business with them.

Additional **administrative burden was the most commonly anticipated drawback** of registering (cited by 35% of voluntary registered and 31% of mandatory registered businesses). Reflecting initial expectations, extra paperwork and administration was the most frequently mentioned drawback after registering – although, when prompted, the majority of businesses disagreed administration is too much of a burden. The qualitative research also found the administration was not overly onerous; businesses explained that compiling and checking quarterly returns was the principal burden, more

than day-to-day record keeping. Other drawbacks related to the **financial impact of VAT registration**, such as the need to increase prices or the reduction in profit. After registering, most businesses kept their prices the same (52%) although 25% did increase them (23% were VAT registered from the start). Around one in ten businesses (11%) specifically mentioned the increased cost of undertaking extra administration as one of the main disadvantages of being registered; after prompting 78% said they had incurred costs, usually increased accountant bills.

Virtually all businesses paid their VAT quarterly (98%) and **most accepted the stagger period they were allocated** when they first registered – only five per cent recall ever requesting a different one. Typically businesses were unable to see any clear advantage in changing this – as most were filing quarterly, it was seen as unlikely that all dates would fall at a ‘good period’. Furthermore, views were mixed on the prospect of aligning VAT quarterly cycles with quarterly cycles of other taxes.

Of the three VAT support schemes asked about, **usage was highest for the Flat Rate scheme** (46%), followed by the Cash Accounting scheme (15%) and Annual Accounting scheme (5%). Experience of the schemes was mainly positive, with the benefits realised similar to the reasons given for deciding to use them. The primary reason for using the Cash Accounting scheme was financial, while businesses were more likely to mention administrative benefits for taking up the Flat Rate or Annual Accounting scheme. Businesses in the qualitative research explained that the Cash Accounting scheme improved cash-flow when invoices were not paid on time. The Flat Rate scheme removed the need to determine different rates, which was perceived to be the most complex aspect of VAT, and avoided the need to keep track of how much VAT was paid. Businesses who used the Annual Accounting scheme found the fixed monthly payments made for greater continuity in accounting, and the requirement to submit one VAT return a year (rather than four) reduced burden. Lack of awareness and understanding was the key reason for non-take up of the schemes.

**A majority agree that businesses which use illegal means to avoid paying VAT are likely to be caught**; with unregistered borderline businesses more likely to have this view (79% compared to 67% of registered businesses). Businesses were **divided on whether it is common for businesses to find ways to remain outside of the VAT system or reduce their VAT bill**, with at least three in ten in each group unable or unwilling to give an opinion.

Overall, **20% of unregistered borderline businesses admit to having taken some action to remain under the threshold and outside the VAT system**. Businesses restricted their turnover in several different ways (sometimes illegally), with the most common being closing the business or stopping advertising (47% of those restricting turnover admitted this), refusing or turning down work (21%), asking customers to purchase materials (16%), reducing prices of products to ensure the VAT threshold is not reached or splitting the business by operating as a separate legal entity or artificially separating the business by product or service (both 10%). Most unregistered borderline businesses felt they would find it difficult to increase prices to cover VAT charges (78%) and this was perceived as a major barrier among those taking part in the qualitative research.

Most businesses restricted their turnover to remain outside the VAT system because they **expected VAT registration to negatively affect their profit, or their competitiveness** if the cost was passed on to their customers. Businesses with a higher proportion of business-to-consumer sales and low input costs perceived a substantial financial impact. The qualitative research also found that restricting business activity often involved considerable effort and monitoring of turnover, and turning down work could impact on a business’ reputation. Some businesses felt frustrated that they were not able to grow without incurring this financial impact. Several measures were suggested to reduce the financial shock for businesses, from simply increasing the VAT threshold to full redesigns of the system.

## 2 Introduction

### 2.1 Background

This HM Revenue and Customs (HMRC) report covers findings from Ipsos MORI research into business behaviours and experiences associated with VAT registration.

Businesses must register for VAT with HMRC if their taxable supply turnover is more than £82,000.<sup>1</sup> Businesses can decide to register voluntarily if their taxable supply turnover is below this threshold. Once registered, businesses must report to HMRC the amount of VAT they have charged for their goods or services and the amount of VAT they have paid for goods or services to other businesses. If the amount charged is above the amount paid, the business must pay the difference to HMRC. If the amount charged is below the amount paid, the business can reclaim the difference from HMRC.

Businesses can usually reclaim the VAT paid on goods and services purchased for business use (if a purchase is also for personal or private use, they can only reclaim the business proportion of the VAT). The business must keep records to support its claim and show how it arrived at the business proportion for a purchase. It must also have valid VAT invoices. Other things that businesses cannot reclaim VAT for include goods and services the business uses to make VAT-exempt supplies, business entertainment costs and anything bought from other EU countries (it may be able to reclaim VAT charged under the electronic cross-border refund system).<sup>2</sup>

HMRC's current understanding of business' considerations when deciding to register for VAT and their initial interaction with the VAT system once registered is limited. This research aims to bridge this knowledge gap, and in doing so to assist HMRC in delivering a tax system that helps these businesses to invest and thrive.

Their key research objectives were to explore:

- The main factors that affect a business' decision to voluntarily register for VAT when their turnover is below the VAT threshold;
- The main issues faced by newly VAT registered businesses, whether the current VAT simplification schemes address these issues and how they could be improved;<sup>3</sup> and
- The types of businesses that purposively restrict business activities to remain below the VAT threshold, their main reasons for doing so and how they ensure they remain below the threshold.

### 2.2 Methodology

In order to meet the research objectives, the research focused on three groups of businesses:

- Businesses that had voluntarily registered for VAT in 2013/14 and 2014/15 when their turnover was below the VAT threshold;

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<sup>1</sup> This is the VAT threshold for the 2015/16 financial year; VAT registration and deregistration thresholds have been revalorised annually in line with inflation.

<sup>2</sup> More information of the circumstances in which a business can reclaim VAT is here: <https://www.gov.uk/reclaim-vat/what-you-can-and-cant-reclaim>

<sup>3</sup> HMRC has several simplification schemes to support smaller businesses within the VAT system.

- Businesses whose turnover exceeded the VAT threshold but was below £150,000 when registering in 2013/14 and 2014/15 and therefore are mandatory registered; and
- Businesses that are not registered for VAT and whose turnover was up to £7,000 below the VAT threshold in 2012/13 and 2013/14 (referred to throughout as 'unregistered borderline businesses').<sup>4</sup>

The research comprised two distinct strands of work:

- A random probability telephone survey of 2,009 businesses to obtain a representative view of experiences of VAT registration; and
- In-depth telephone interviews with 40 businesses that had agreed to be re-contacted from the survey to provide insight into businesses' behaviours and decision-making.

### 2.2.1 Quantitative telephone survey

Questionnaire development for the survey was informed by a small-scale pilot. Fieldwork for the survey took place between 20 January and 21 March 2016. Interviews were conducted with the company owner or the person in the business with the best understanding of the administration of dealing with taxes or VAT. The average interview length was 22 minutes.

Businesses were selected from HMRC administrative data to be representative of the groups outlined above. A breakdown of the sample used and response rates can be found in Appendix 1. Weighted and unweighted profile figures are presented in Appendix 3.

### 2.2.2 Qualitative follow-up interviews

Depth interviews were conducted between 18 February and 23 March 2016. Interviews were recorded, with the permission of participants, and lasted around 45 minutes. The sample was drawn from the three core groups, identified by their answers to the survey. In the unregistered borderline group, the research focused on businesses who admitted to taking actions to restrict their turnover in the survey. The sample was structured to ensure coverage of a range of businesses within the three groups, including use of VAT simplification schemes and use of agents for registered businesses, and different actions borderline businesses take to restrict their turnover. The sample profile is outlined in Appendix 3.

## 2.3 Interpretation of findings

### 2.3.1 Quantitative data

This report only comments on sub-group differences that are statistically significant at the 95% level of confidence. Statistical significant calculations were carried out based on the effective sample size - that is the sample size once the effect of design and non-response weighting is taken into account. Throughout the report, findings marked with an asterisk (\*) represent a result of less than half a per cent, but more than zero.

### 2.3.2 Qualitative data

The data was analysed using an inductive approach whereby interview recordings were transcribed, summarised under thematic headings and analysed for themes, patterns and sub-group differences and similarities. Qualitative research is

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<sup>4</sup> Within the unregistered borderline group, the research focused on active businesses in the private sector, excluding the financial and insurance sector and businesses which sell goods or services exempt from VAT.

used to map the range and diversity of different types of experiences rather than indicate the prevalence of any one particular experience; as such, numerical language has not been used when reporting on the qualitative findings.

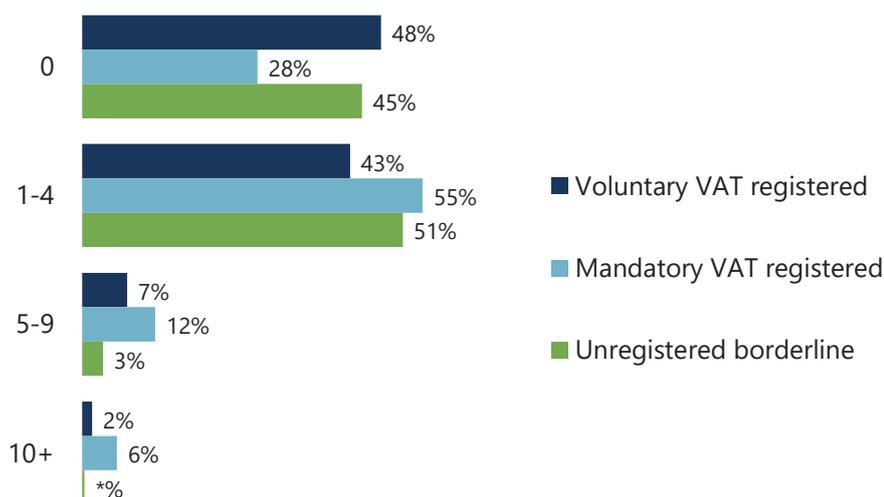
## 3 Current business practices

This chapter sets out the key characteristics of the businesses that participated in the study. It also explores the use of accounting systems and agents for tax administration. Further information on the characteristics of the businesses is provided in Appendix 4<sup>5</sup>. This provides contextual information on the kinds of businesses that fall within the study's three business population groups.

### 3.1 Size of business

The majority of businesses were nano businesses with no employees other than the respondent or were micro businesses with 1-4 employees. VAT registered businesses tended to be larger than unregistered borderline businesses (with mandatory larger than voluntary within the VAT registered group).

**Figure 3.1: Number of employees**



Base: All voluntary registered (760); All mandatory registered (644); All unregistered borderline businesses (604) (Don't know/refused excluded: voluntary registered = \*%; mandatory registered; unregistered borderline = 0%)

There were some sectoral variations - for example, a higher proportion of nano businesses were in the information/communications, professional, scientific and technical, and administration/support sectors; those with employees were more prevalent in the wholesale and retail trade and accommodation and food services.

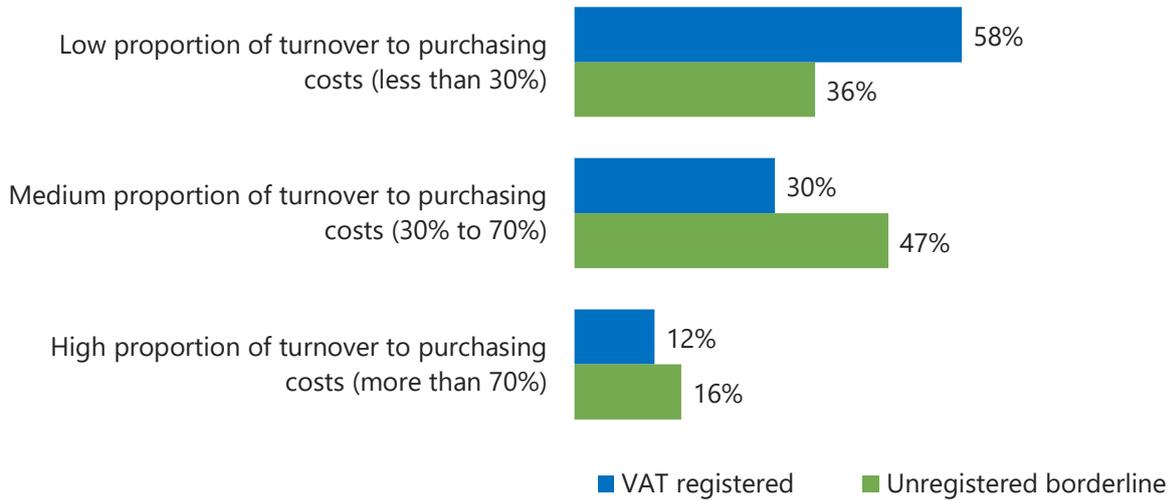
### 3.2 Total cost of purchasing goods and services

Around four in ten VAT registered businesses spent up to £10,000 purchasing goods and services from other businesses in the last financial year. This was higher among voluntarily registered businesses (44% spent up to £10,000 compared to 31% mandatory registered businesses).

<sup>5</sup> Data is provided on trading status at the time of the interview, number of directors, sector of activity, turnover in the last financial year and length of trading (Tables A.6 to A.10).

Figure 3.2 shows the proportion of turnover by input costs. On the whole VAT registered businesses were more likely to have low input costs as a proportion of turnover compared with unregistered businesses, and a higher proportion of unregistered businesses had medium input costs.

**Figure 3.2: Purchasing costs by turnover**

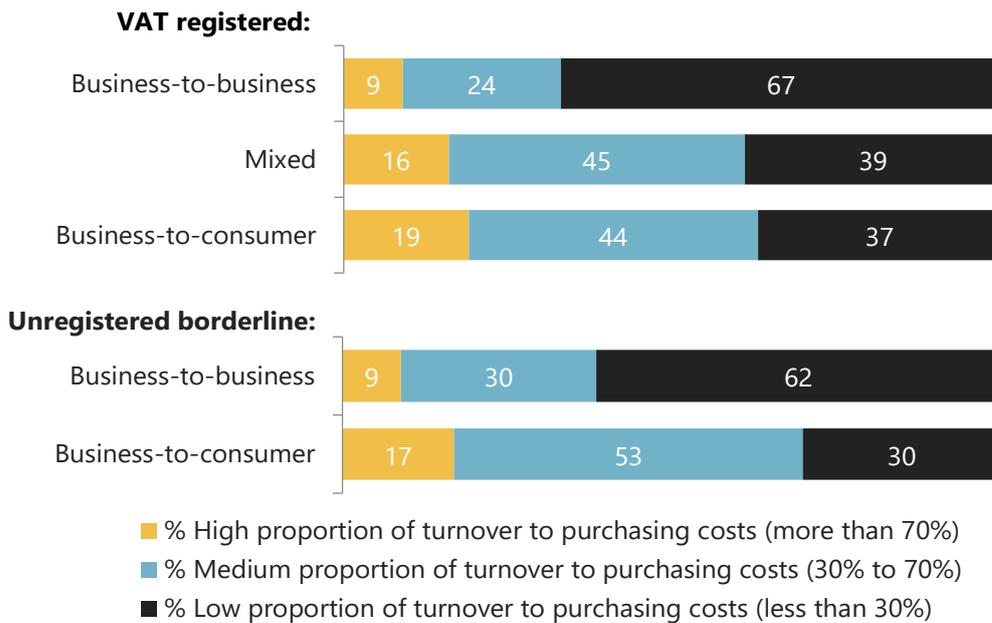


Base: All VAT registered (1,031); All unregistered borderline businesses: (449) (Don't know/refused excluded: VAT registered = 25%; unregistered borderline = 25%)

There were some key differences by whether the business mainly made business or consumer sales, sector and financial performance:

- Those with mainly business-to-business sales were more likely to have low input costs as shown in Figure 3.3 overleaf;

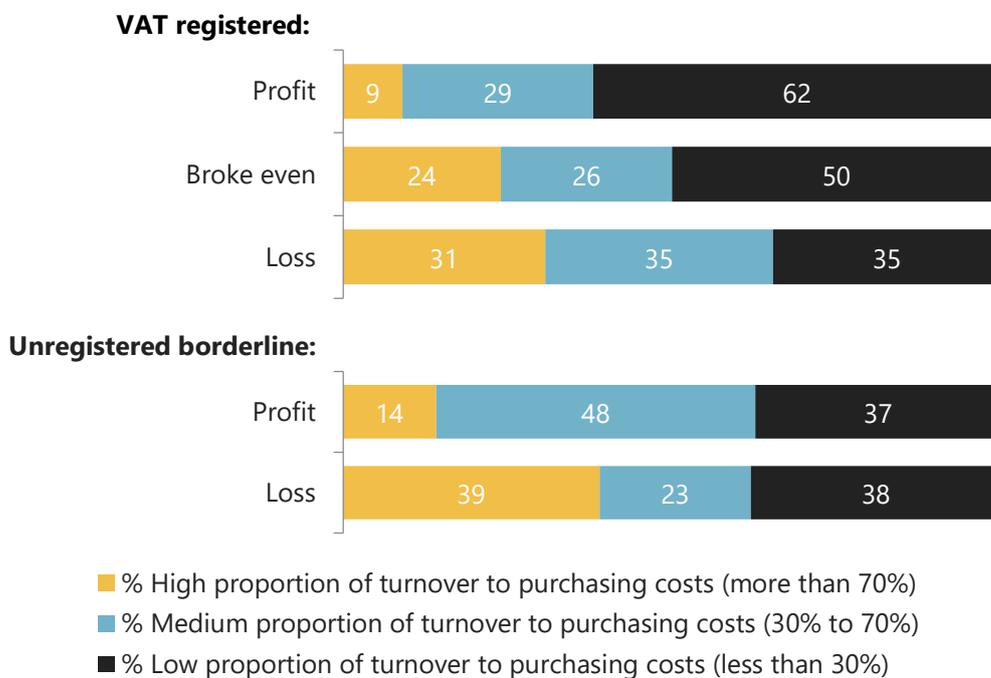
**Figure 3.3: Purchasing costs by sales to businesses and consumers**



Base: All VAT registered (607 mainly business-to-business; 327 mainly business-to-consumer; 59 mixed); All unregistered borderline businesses: (62 mainly business-to-business; 331 mainly business-to-consumer; mixed not shown due to small base [25]) (Don't know/refused excluded: VAT registered = 25%; unregistered borderline = 25%)

- There were also some differences by sector among VAT registered businesses - businesses in the information and communications sector were more likely to have low input costs (86% compared with 59% of all VAT registered businesses), as were those in the professional, scientific and technical sector (71%). Businesses in the wholesale, retail, accommodation and food services sector were more likely to have high input costs (24% compared with 12% overall);
- Among VAT registered businesses, smaller businesses tended to have lower input costs. Three in five (61%) of those with less than five employees had low input costs, compared with just 34 per cent of those with five or more employees; and
- Those who made a profit in the last financial year were less likely to have high input costs as can be seen in Figure 3.4 overleaf.

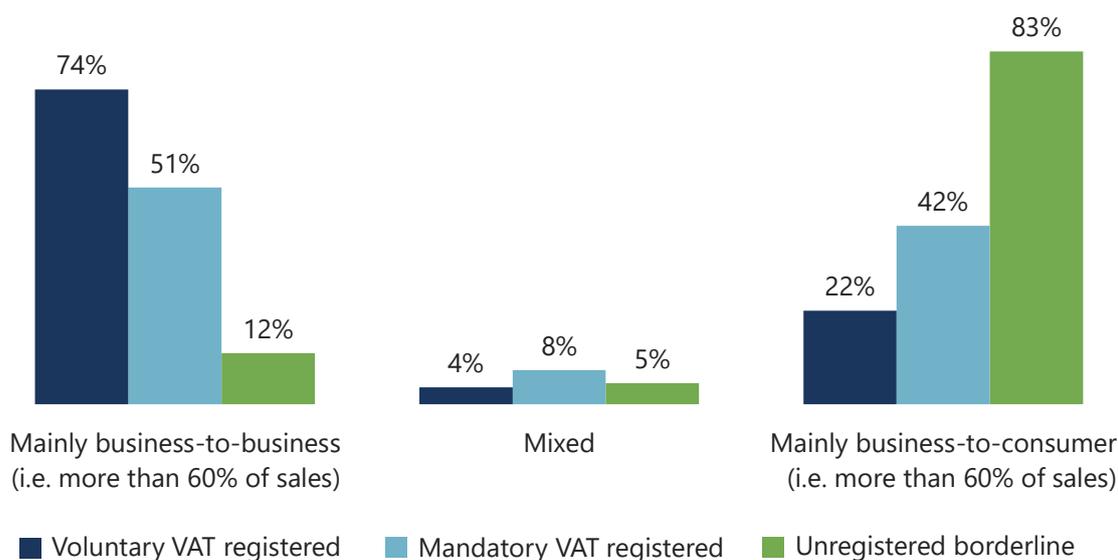
**Figure 3.4: Purchasing costs by financial performance in the last year**



Base: All VAT registered (835 made a profit; 100 made a loss; 38 broke even); All unregistered borderline businesses (385 made a profit; 33 made a loss; broke even not shown due to small base [26]) (Don't know/refused excluded: VAT registered = 25%; unregistered borderline = 25%)

### 3.3 Business and consumer sales

VAT registered businesses were more likely than unregistered borderline businesses to make most (i.e. more than 60%) of their sales to other VAT registered businesses, especially those that voluntarily registered. In contrast, the majority of unregistered borderline businesses' sales were to other unregistered businesses or directly to consumers.

**Figure 3.5: Sales to businesses and consumers**

Base: All voluntary registered (715); All mandatory registered (617); All unregistered borderline businesses (555) (Don't know/refused/other excluded: voluntary registered = 6%; mandatory registered = 4%; unregistered borderline = 8%)

There were some key differences by legal status and number of employees:

- For the VAT registered businesses, companies were more likely than sole traders/partnerships to make mainly business-to-business sales (71% compared with 35%). A majority of sole traders and partnerships (57%) mainly sold to consumers (and 24% sold mainly to businesses); and
- Among both VAT registered and unregistered borderline businesses, nano businesses were more likely to make business-to-business sales – most sales made by VAT registered nano businesses were to other businesses (75% of nano businesses mostly sold to other businesses compared with 55% of businesses with employees) – the corresponding figures for unregistered borderline businesses are 17 per cent and seven per cent respectively.

Tables A.11 and A.12 in Appendix 4 show the methods of accounting for sales. Tables A.13 to A.15 present the ways in which customers can pay for products and services and businesses' preferred methods of receiving payments.

### 3.4 Use of an agent for tax affairs

Around four in five (78%) VAT registered businesses used an accountant or a tax advisor for VAT-related tax administration. Use of accountants and tax advisors for tax affairs more generally was also high among unregistered businesses (86%).

In both populations, smaller businesses were less likely to use an agent as shown in Figure 3.6.

**Figure 3.6: Use of agent by size of business**

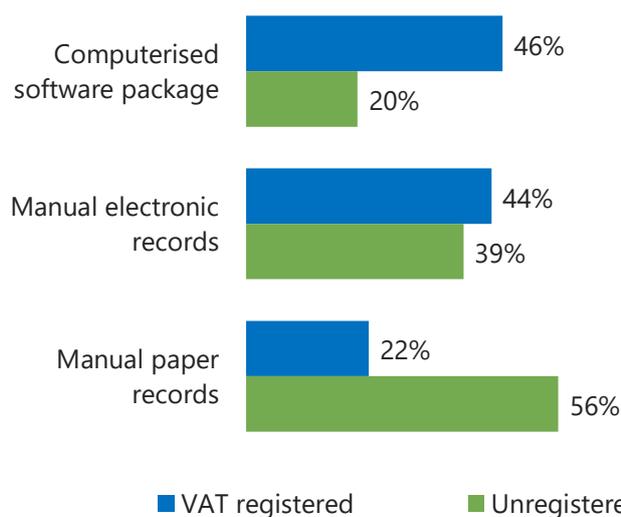
Base: All VAT registered (1,201 nano/micro businesses [i.e. 0-4 employees]; 202 with 5+ employees); All unregistered borderline businesses (263 nano businesses; 337 with 1+ employees) (Don't know/refused/other excluded: voluntary registered = \*%; unregistered borderline = 1%)

Unregistered borderline businesses who expect the business to decline in the next 12 months were also less likely to have a tax agent (26% did not compared with 12% expecting to stay the same and 12% expecting to grow). VAT registered businesses using paper accounting were more likely to have an agent (84%), although this pattern was not apparent among unregistered borderline businesses.

The qualitative research found that the role accountants played in tax and VAT administration varied considerably depending on the businesses' prior experience of VAT. For businesses with substantial experience, accountants were typically used for advice on specific points or to check over VAT returns that the business had compiled. For businesses with less experience and familiarity with VAT, accountants would guide and support businesses in how to administer VAT. For businesses with very low understanding of VAT, accountants were more commonly given full responsibility for compiling, checking and submitting the return, based on invoices and receipts provided by the business. Businesses had not typically hired an accountant solely for VAT, but, rather, were helped by their own accountant whose previous role was to check over self-assessment or corporation tax returns.

### 3.5 Use of manual and electronic systems

Respondents were asked if they account for sales and purchases with manual paper or electronic records, or a computerised software package such as SAGE or free HMRC software. Most VAT registered businesses used some form of electronic system for accounting for sales and purchases – 46 per cent used a computerised software package and 45 per cent used manual electronic records. Unregistered borderline businesses more commonly used manual paper records (56%). There were no significant differences in accounting for sales and purchases between mandatory and voluntary registered businesses.

**Figure 3.7: Accounting systems<sup>6</sup>**

Base: All VAT registered businesses (1,405); All unregistered borderline businesses (604) (Don't know/refused/other excluded: VAT registered = 4%; Unregistered borderline = 3%)

However, there were some variations among the other main sub-groups:

- Larger VAT registered businesses were more likely to use software packages (65% with 5+ employees compared with 47% of micro businesses and 39% nano businesses); nano and micro businesses were more likely to use manual electronic records (50% and 45% respectively compared with 24% with 5+ employees);
- VAT registered businesses who expect to grow in the next 12 months were also more likely to use software packages (52% compared with 43% who expect to stay the same and 40% who expect to decline);
- Unregistered businesses not using agents were more likely to use software packages (28% compared with 19% with an agent). In both populations, businesses using an agent were more likely to use paper accounting (24% compared with 16% of VAT registered businesses who do not use an agent, among unregistered borderline businesses the respective figures were 57% and 47%);
- VAT registered businesses with mainly business-to-business sales were more likely to use manual electronic records, such as a personally designed spreadsheet (50% compared with 36% business-to-consumer sales); VAT registered businesses mainly selling to consumers were more likely to use paper accounting (29% compared with 19% mainly business-to-business sales and 18% with mixed sales);
- VAT registered companies were more likely to use manual electronic records (46% compared with 38% sole traders/partnerships); VAT registered sole traders/partnerships were more likely to use paper accounting (42% compared with 18% of companies); and
- VAT registered businesses operating more than 10 years were more likely to use paper accounting (36% compared with 21% of those who had operated up to 10 years).

<sup>6</sup> The percentages total to more than 100% as it was possible to give more than one response at this question as businesses can use more than one accounting system for sales and purchases.

## 4 Business growth

This section examines the financial performance of businesses, difficulties faced in the early years of trading and prospects for future growth. It also looks at expectations for reaching the VAT threshold among unregistered borderline businesses, and VAT registered businesses below the threshold.

### 4.1 Financial performance

The majority of businesses made a profit in 2014/15, 85 per cent of VAT registered businesses and 88 per cent of unregistered borderline businesses. A small proportion broke even or made a loss (5% and 10% respectively for VAT registered businesses and 6% and 7% for unregistered borderline businesses).

Business-to-business organisations were more likely to have made a profit: this was the case for both VAT registered businesses (91% made a profit compared with 73% business-to-consumer organisations) and unregistered borderline businesses (95% compared with 85%).

Table A.16 in Appendix 4 shows the overall change in number of employees and turnover since VAT registration for businesses that did not register in the last financial year. There is some evidence of growth among both voluntary and mandatory registered businesses, with around twice as many businesses now having 5-9 employees, and a significantly higher proportion with a turnover of more than £100,000.

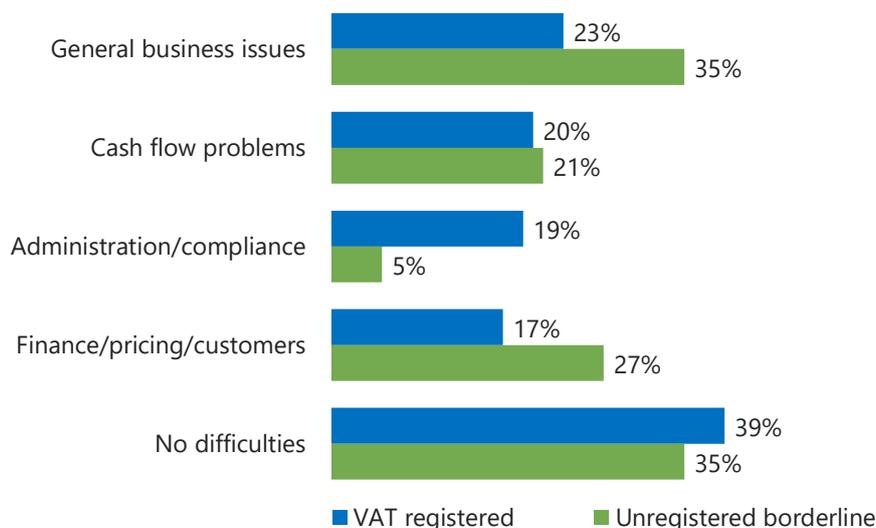
### 4.2 Difficulties faced in early years

Registered businesses that were less than five years old when they registered as well as unregistered businesses that are less than five years old were asked if they had faced any difficulties in the first two years of business. Over a third reported no difficulties (39% of registered businesses and 35% of unregistered borderline businesses).

Among those reporting difficulties, the issues most commonly encountered were general business issues such as strong competition, establishing the brand, adverse economic conditions, and personal and staff issues. During the early years of trading, managing cash flow and finding/keeping customers were also cited as key challenges. A full breakdown of the difficulties faced by businesses in their early years is outlined in Table A.17 in Appendix 4.

Unregistered borderline businesses were much less likely than VAT registered businesses to cite challenges relating to administration or compliance (just 5% did compared with 19% of VAT registered businesses) and were more likely to mention general business issues (35% compared with 23%) and problems related to finance, pricing and customers (27% compared with 17%).

More VAT registered businesses specifically mentioned bureaucracy and red tape (9% said this was a problem compared with 1% of unregistered borderline businesses) and general tax compliance (8% compared with 3%).

**Figure 4.1: Difficulties faced by businesses in early years (grouped responses)<sup>7</sup>**

Base: All VAT registered businesses less than five years old when they registered/unregistered borderline businesses less than five years old (VAT registered: 1,156; Unregistered borderline businesses: 84)

VAT registered businesses with low input costs as a proportion of turnover were more likely to have experienced no difficulties in the first two years of business (46% compared with 26% medium input costs and 30% high input costs). They were therefore less likely to have encountered most of the difficulties cited, with the exception of administration and compliance, and specifically bureaucracy, which they were as likely to mention as other businesses (for example 9% of VAT registered businesses with low input costs mentioned bureaucracy compared with 9% medium input costs and 8% high input costs).

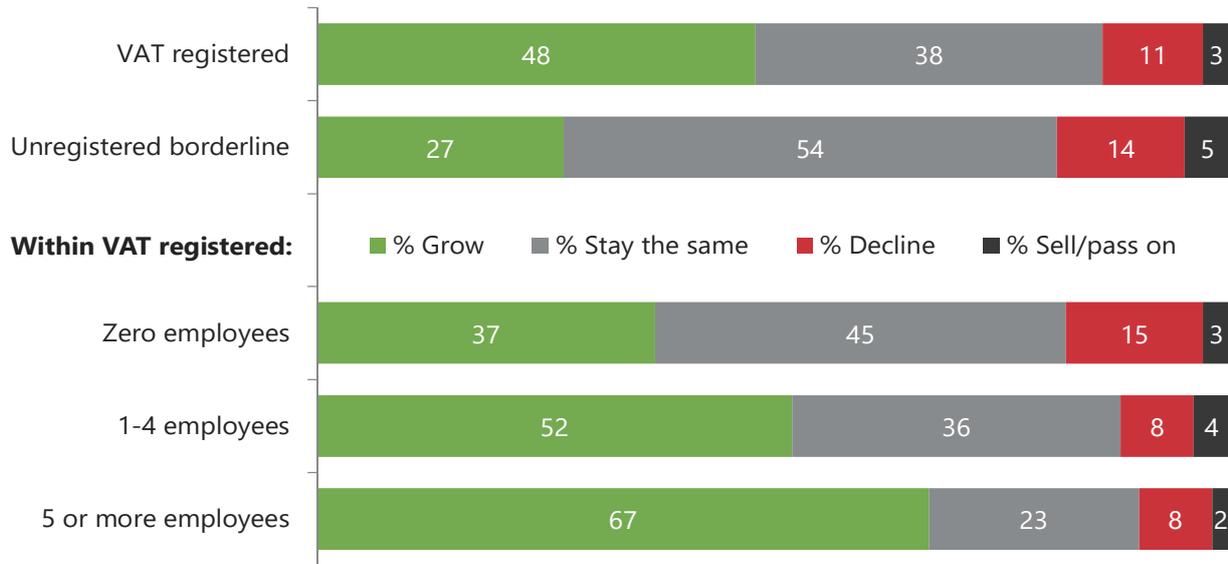
More recently established VAT registered business were more likely report no difficulties (40% who had been operating for up to five years compared with 24% who had been operating longer<sup>8</sup>). Among those reporting difficulties, businesses operating for at least five years overall were more likely to mention general business issues in the two years of business (38% compared with 21% who had been operating for less than five years) but were less likely to cite administration or compliance issues (12% compared with 20% of newer businesses).

### 4.3 Prospects for future growth

The majority of both VAT registered and unregistered borderline businesses expected to grow or stay the same in the next 12 months. VAT registered businesses were more likely to expect to grow whilst borderline unregistered businesses were significantly more likely to expect to remain the same.

<sup>7</sup> This chart shows the difficulties cited banded into themes. For a full breakdown please see Table A.17 in Appendix 4.

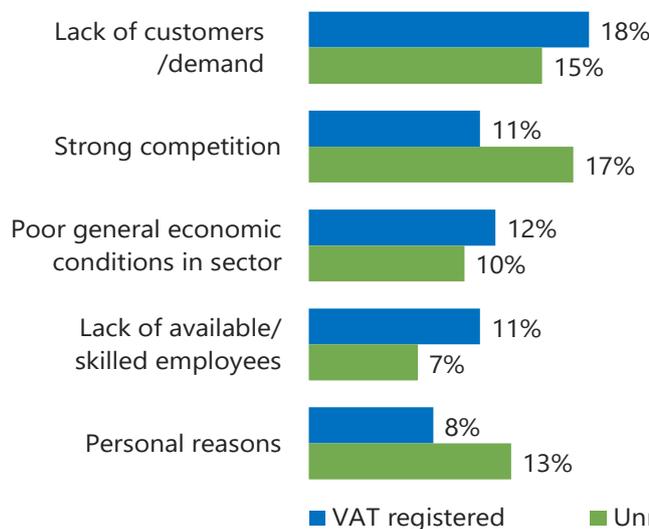
<sup>8</sup> While this question was asked of VAT registered businesses less than five years old when they registered, some businesses have been operating longer than this in total.

**Figure 4.2: Expectations for growth in the next 12 months**

Base: All businesses that still exist/are owned by respondent (VAT registered: 1,355, Unregistered borderline: 604; Zero employees: 500; 1-4 employees: 653; 5+ employees: 201) (Don't know/refused excluded: VAT registered = 2%; Unregistered borderline = 3%)

While there were no significant difference in growth expectations between voluntary and mandatory registered businesses, larger VAT registered businesses were more optimistic with almost twice as many with 5+ employees than nano businesses anticipating growth (67% compared with 37%).

Businesses were asked what they perceived to be the greatest barriers to growth over the next 12 months. A variety of barriers were cited, with VAT registered businesses most commonly mentioning lack of customers/demand, and borderline unregistered businesses suggesting strong competition was the main challenge. Registered businesses were more likely than unregistered borderline businesses to cite a lack of available or skilled employees as a barrier, while more unregistered borderline businesses mentioned personal issues, such as doing something else, losing interest or illness. Relatively few thought that administration would be a barrier in the next year, with four per cent each of VAT registered and unregistered borderline businesses citing it. For VAT registered businesses this contrasted with the proportion experiencing this sort of difficulty in the business' early years.

**Figure 4.3: Top five barriers to growth in the next 12 months**

Base: All businesses that still exist/are owned by respondent (VAT registered: 1,354, Unregistered borderline businesses: 604)

Looking at VAT registered businesses, business-to-business organisations were more likely to cite lack of customers/demand (20% compared with 14% business-to-consumer and 7% mixed). Business-to-consumer businesses were more likely to refer to strong competition (16% compared with 9% mainly business-to-business and 6% mixed).

VAT registered businesses who expect to grow in the next 12 months were more concerned about a lack of available or skilled employees (17% compared with 6% of those who expect to stay the same and 4% who expect to decline).

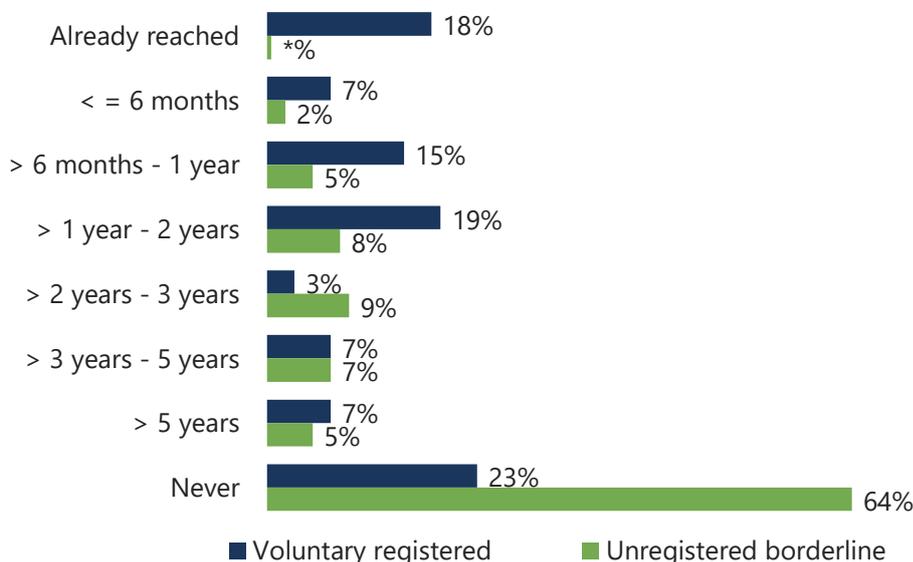
VAT registered nano businesses were more likely to refer to personal reasons (13% compared with 5% with employees), as did registered businesses who expect to decline in the next 12 months (16% compared with 7% who expect to stay the same and 6% who expect to grow). Registered businesses who expect to decline were also more likely to mention poor economic conditions in their sector (26% compared with 11% who expect to stay the same and 10% who expect to grow).

#### 4.4 Expectations for reaching VAT threshold

Looking ahead, 63 per cent of unregistered borderline businesses never expect their business to reach a turnover of £82,000 (the current VAT threshold) – only seven per cent think it will take up to one year and a further 17 per cent say it will take between one and three years.

A much lower proportion of voluntarily registered businesses do not expect to reach the current VAT threshold (23%). Two-fifths (40%) claim to have already reached it or expect to reach to within the next year.

**Figure 4.4: Expectation for reaching the VAT threshold**



*Base: All voluntary registered who have not reached the VAT threshold (437); All unregistered borderline businesses who have not reached the VAT threshold (423) (Don't know/refused excluded: VAT registered = 6%; Unregistered borderline = 14%)*

#### 4.5 Reasons for closing or selling on the business

Few VAT registered businesses (just 4%) had, at the time of interview, ceased trading or sold or passed on the business. The most common reasons for this were personal factors such as moving on to something else, losing interest in the business, retiring or due to illness (these factors were cited by 38 out of the 59 businesses).

Similarly only two per cent of unregistered borderline businesses and one per cent of VAT registered businesses currently intend to sell or pass on the business in the next 12 months. Again personal factors were the most common reason cited (26 out of 45 registered businesses and 21 out of 29 unregistered borderline businesses).

## 5 Knowledge about VAT

This section examines the level of knowledge that respondents had about VAT registration. It also looks at the nature of the advice or help they received when deciding to register.

### 5.1 Sources of information, help and advice

Businesses registered for VAT principally relied on their accountant for information, help or advice when deciding to register (67%). This was even more common among mandatory registered sole traders (78%) and businesses mainly selling to consumers (75%).

The next most common source of information was HMRC (14%), particularly among businesses without an agent (28% compared with 10% with an agent), voluntarily registered businesses (16% and 11% mandatory registered) and businesses who mostly sell to other businesses (16% and 10% business-to-consumer).

The qualitative research revealed that VAT registered businesses that were originally unfamiliar with VAT tended to use their accountants as the primary source of advice on VAT registration. The gov.uk website and HMRC helpline tended to be used for preliminary research, but also to answer more specific queries, especially from businesses that already had a good understanding of VAT.

***“The HMRC website has got all the information on the thresholds and rates and all that sort of stuff and we do have an accountant and he will answer any questions that I’ve got, so the information’s all there for me basically.”***

Mandatory VAT registered, Flat Rate

Among unregistered borderline businesses, 57 per cent had sought information or advice from an accountant about registering for VAT and 11 per cent from HMRC.

### 5.2 Usefulness of advice from HMRC

Among the 14 per cent of VAT registered business who sought advice and information from HMRC, the majority (93%) found the advice useful (including 46% ‘very useful’). Businesses that voluntarily registered were even more likely to rate the advice useful (95% compared to 88% of mandatory registered businesses).

Among the 11 per cent of unregistered borderline businesses that sought advice from HMRC, again most (91%) rated the information useful, with an even higher proportion than VAT registered businesses rating it ‘very useful’ (62%).

In the qualitative research, businesses found that information on the VAT sections of the gov.uk website was typically helpful and of a high quality. The extensive use of examples in particular was praised for helping businesses to understand how the rules would work in practice. Experiences of the helpline were more mixed, as the knowledge of advisors was found to vary considerably. Initial problems with waiting for the call to be answered were also mentioned.

### 5.3 Awareness of aspects of VAT among registered businesses

VAT registered businesses were asked if prior to registering they were aware of five different aspects of VAT. Overall three in five (63%) businesses were aware of all of five aspects, but awareness was exceptionally high across most of the aspects asked about. At least nine in ten businesses were aware that:

- *Once registered the business is required to submit accurate returns on time (98%);*
- *Failure to submit accurate returns may result in a penalty or HMRC assessment (96%);*
- *They could claim VAT back from purchases made from VAT registered businesses (93%); and*
- *There would be additional record keeping and administration involved when becoming VAT registered (91%).*

Fewer were aware that when registering for VAT they would *lose profit if they did not increase their prices* – although still 70 per cent claimed to know this and mandatory registered businesses had higher levels of awareness (74% compared with 67% voluntary registered).

Younger businesses were more likely to be unaware that if prices are not increased when VAT registered profit will be lost (25% trading up to 5 years compared with 18% trading 5+ years), as were nano businesses (30% compared with 20% with employees) and those mainly trading with other VAT registered businesses (27% compared with 16% mainly trading with consumers). Respondents were also more likely to be unaware if they had an agent overseeing VAT administration (26% compared with 18% without an agent) or if they had never previously owned a VAT company (26% compared with 18% who had owned one).

The qualitative research suggests that levels of awareness of VAT were closely linked to prior experience; either running or working in a VAT registered business in the past or from attending financial training as part of previous employment, such as accountancy training.

Where understanding was low prior to registration, businesses had relied on their own research and discussions with accountants. There were also businesses whose understanding remained poor, because they lacked either interest or aptitude, and who were accordingly much more reliant on their accountant.

### 5.4 Awareness of aspects of VAT among unregistered borderline businesses

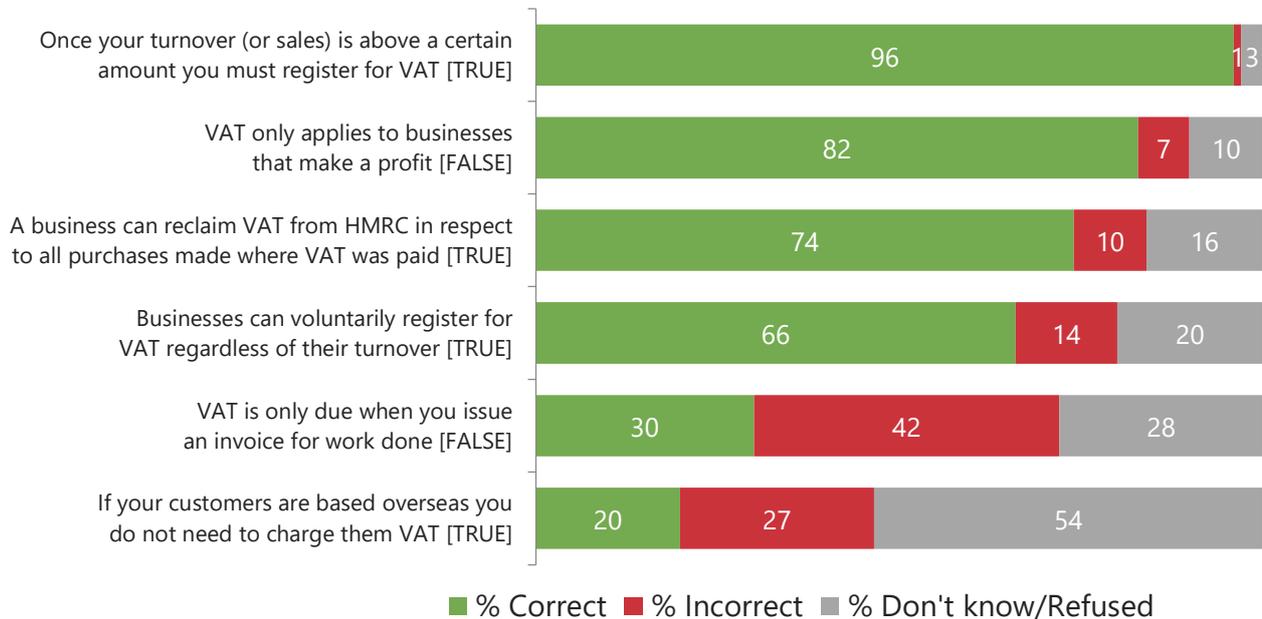
In order to assess unregistered borderline business' knowledge more objectively, the questionnaire included a series of statements about VAT registration; respondents were asked whether they thought each one was true or false.

Virtually all were aware *businesses should register for VAT once their sales are above a certain threshold (96%)* though only 28 per cent knew the current VAT threshold was £82,000 (see Table A.18 in Appendix 4 for the full set of responses given).

The majority of businesses knew *VAT does not only apply to businesses that make a profit (82%)* and that *businesses can reclaim VAT from HMRC in respect to all purchases made where VAT was paid (74%)*. Two-thirds correctly answered that businesses can *voluntarily register for VAT regardless of their turnover (66%)*, with nano businesses and those expecting to remain the same size or decline in the next 12 months having higher levels of understanding (70% and 70% compared to 63% with employees and 60% who expect to grow). Businesses were less certain whether *VAT is only due when the invoice has been issued (only 30% correctly answered)*.

The greatest uncertainty was about whether *customers based overseas need to be charged VAT* (53% 'don't know') with only one in five (20%) correctly answering. However, nano businesses were again more likely to be aware of this (24% compared to 16% with employees).

**Figure 5.1: Awareness of VAT registration among unregistered borderline businesses**



Base: All unregistered borderline businesses (604)

As might be expected, those who have owned a VAT registered business (either currently or previously), had higher levels of understanding; for example, these businesses were more likely to know VAT does not only apply to businesses which make a profit (93%) or that businesses can reclaim VAT (81%) compared with businesses which have never owned a VAT registered business (77% and 72% respectively).

In the qualitative research, knowledge of the current VAT system varied amongst businesses that were deliberately restricting their turnover – with those closest to the threshold expressing greater awareness. Where businesses knew they were close to the threshold they often described keeping a close eye on this aspect of the VAT system, for example, following the Budget statements.

The qualitative research also showed that businesses that were restricting their turnover tended to understand broadly how VAT worked as a tax, and how becoming VAT registered would financially impact their business. It was typical, however, for these businesses to lack knowledge on what the process of VAT record keeping would involve.

## 6 Reasons for registering for VAT

This section examines the main factors that affect a business' decision to voluntarily register for VAT when their turnover is below the VAT threshold, as well as reasons given by those above the threshold. It also looks at concerns that respondents had before making the decision to register.

### 6.1 Registration reasons for businesses below VAT threshold

When asked, without prompting, why they decided to register for VAT, voluntarily registered businesses were most likely to say they expected to grow and would soon reach the VAT threshold (33% gave this reason and 26% said it was the main reason). Being advised to register by an agent or accountant, the ability to claim back VAT from HMRC on purchases from other VAT registered businesses and improved reputation or credibility were the next most common reasons.

**Table 6.1: Most common reasons for registering for VAT – Voluntary registered<sup>9</sup>**

	Reasons	Main reason
<i>All voluntary registered businesses (761)*</i>		
<b>Default reasons</b>	<b>70%</b>	<b>59%</b>
Business growth/turnover exceeding the threshold	33%	26%
Agent/accountant advised it	23%	20%
Thought I had to	10%	8%
New company and VAT registered from the start	10%	5%
<b>Financial reasons</b>	<b>25%</b>	<b>17%</b>
To claim back VAT on purchases	18%	13%
Mainly sell to other VAT registered businesses	8%	3%
<b>Help business growth/image</b>	<b>22%</b>	<b>17%</b>
Improved reputation/credibility	15%	8%
More appealing to customers/suppliers	8%	6%
To help my business grow	4%	2%

\* Mentions 2% or less not shown

Prior knowledge of VAT appeared to influence the reason for the registration decision. Businesses with only some prior knowledge were more likely to register because their agent advised it (41% gave it as their main reason compared with 17% of those with extensive knowledge). Those with extensive knowledge were more likely to expect to exceed the threshold (27% gave this as the main reason compared with 18% with some prior knowledge) or be driven by financial reasons (18% compared with 8%)<sup>10</sup>. Businesses with high business-to-consumer sales were more likely to register because they thought they might soon reach the threshold (35% compared with 24% business-to-business and 23% mixed), while businesses with high business-to-business sales cited financial reasons, typically the ability to claim back VAT (15% compared with 7% business-to-consumer and 10% mixed). The smallest businesses were also more likely to cite financial reasons (22% of nano businesses cited it as a main reason compared with 12% with employees).

<sup>9</sup> This table shows the reasons given banded into themes (in bold). The individual percentages will not necessarily add up to the percentage for the group as some respondents gave more than one reason.

<sup>10</sup> This is based on knowledge of five aspects of VAT prior to registration – those with extensive knowledge are aware of at least four aspects and those with some knowledge are aware of two or three aspects.

The qualitative research showed that voluntary registered businesses viewed registration as a precautionary measure: the business was inevitably going to grow over the threshold and they did not want to risk being in breach of HMRC's regulations. The decision to register was, in a number of cases, taken at the point of starting a new business which was expected to approach or exceed the threshold in its first year.

Additional, but secondary, advantages were:

- *Reclaiming VAT on input costs.* For businesses with high input costs this feature of VAT provided considerable financial benefits (mirroring the survey findings above), and was found to offer particular benefit to businesses with high start-up costs.

***"In the development process there was going to be quite a lot of expense, so I was actually able to claim back VAT on those expenses."***

Voluntary VAT registered, No scheme

- *Increased credibility.* In some cases this appeared to be just a perception but there were businesses that gave examples of individual companies that would refuse to trade with them if they were not VAT registered. VAT registration was said to make a company look larger, more established and more stable.

***"Credibility is added to the company; if you're VAT registered it makes it look like you're of a size, not being VAT registered defines you as being very small."***

Voluntary VAT registered, No scheme

Businesses who voluntarily registered for VAT sometimes had prior experience of VAT and so had greater awareness of what being VAT registered would involve and as such were less daunted by it.

## 6.2 Registration reasons for businesses above VAT threshold

As might be expected the majority of businesses whose turnover was above the VAT threshold said exceeding the threshold was the main reason they registered for VAT (spontaneously cited by 67%). Around one in ten said they were advised to by an agent (11%) or they thought registration was compulsory (8%). Few businesses said the main reason was for financial reasons or to help their business grow or improve its image.

**Table 6.2: Most common reasons for registering for VAT – Mandatory registered<sup>11</sup>**

	Reasons	Main reason
<i>All mandatory registered businesses (644) Mentions 2% or less not shown</i>		
<b>Default reasons</b>	<b>92%</b>	<b>88%</b>
Business growth/turnover exceeding the threshold	75%	67%
Agent/accountant advised it	16%	11%
Thought I had to	15%	8%
New company and VAT registered from the start	6%	2%
<b>Financial reasons</b>	<b>12%</b>	<b>5%</b>
To claim back VAT on purchases	10%	5%
<b>Help business growth/image</b>	<b>7%</b>	<b>3%</b>
Improved reputation/credibility	4%	2%
More appealing to customers/suppliers	3%	*%

<sup>11</sup> This table shows the reasons given banded into themes (in bold). The individual percentages will not necessarily add up to the percentage for the group as some respondents gave more than one reason.

Those with extensive knowledge of VAT were more likely to cite financial reasons (5% gave this as a main reason compared with less than half a per cent of those with some prior knowledge). As seen earlier with the voluntary registered, among the mandatory registered business-to-consumer businesses were also more likely to mention exceeding the threshold (72% gave it as a main reason as did 78% of those with mixed sales compared with 61% of businesses who mostly sell to other businesses).

The qualitative research found that, for businesses whose turnover was above the threshold, becoming VAT registered was perceived as a necessary step in allowing their business to grow. Other advantages noted in the qualitative research were similar to those who voluntarily registered: reclaiming VAT on input costs and increased credibility, although these tended to be mentioned less frequently.

### 6.3 Anticipated drawbacks of registering

Two in five VAT registered businesses (41%) did not anticipate any drawbacks prior to registering. Additional administrative burden was the most commonly anticipated drawback, and businesses below the threshold were more likely to expect this after registering (35% compared with 31% mandatory registered). Administration was also a more common concern among smaller businesses (41% of nano businesses cited this compared with 34% micro businesses and 19% with five or more employees) and those with higher business-to-business sales (40% cited this compared with 35% mixed sales and 26% higher business-to-consumer sales).

Businesses above the threshold were more likely to anticipate a financial loss (31% compared with 18%), as were businesses with employees (28% compared with 18% nano businesses) and those with higher business-to-consumer sales (42% compared with 38% mixed sales and 15% higher business-to-business sales). The latter finding relates to these businesses not being able to claim back substantial VAT costs.

A breakdown of concerns in advance of registering is provided in Table A.20 in Appendix 4.

In the qualitative research it was found that all types of businesses had anticipated that administering VAT would require considerable additional administration compared to doing either self-assessment or corporation tax returns. Businesses with prior experience were however more comfortable at the prospect, having typically found it to be manageable previously.

The risk of VAT inspections, making a mistake or incurring a penalty were also cited in the qualitative research as anticipated drawbacks to becoming VAT registered, by businesses with and without prior experience of VAT. More exceptionally, in the qualitative interviews it was suggested that HMRC had an 'image problem' in this regard. Businesses and agents felt that HMRC had a reputation of being overly punitive and unsympathetic towards smaller businesses, especially relating to VAT. In these exceptional cases it was suggested in the interviews that HMRC was unapproachable and that this issue should be addressed if HMRC is to encourage more businesses into the VAT system.

***“People are nervous of contacting HMRC whereas in reality they're there to help and they don't have an axe to grind, they're just trying get paid the right amounts ... they need to sort of almost do some PR that we're not a big ogre ... you don't have to worry about us coming to get you.”***

Compulsory VAT registered, Cash Accounting scheme

## 7 Experiences since registering for VAT

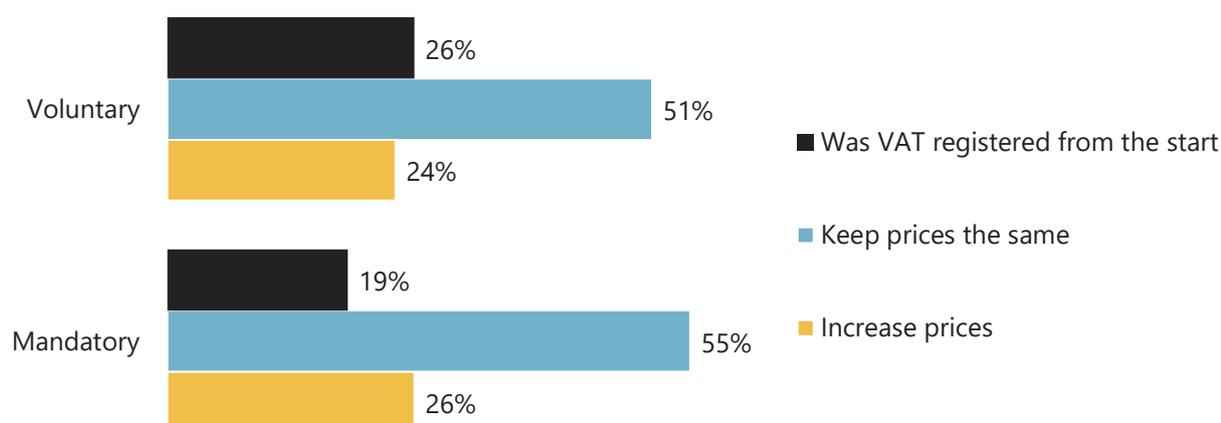
This section examines the experiences of businesses since they registered, including how they are incorporating VAT into their business practices.

### 7.1 How VAT is incorporated into business practices

Almost all VAT registered businesses made the majority of sales at the standard rate of 20% VAT (94%). Just four per cent made at least some zero rated sales and one per cent made at least some 5% VAT sales.

Half of VAT registered businesses (52%) kept their prices the same when they became VAT registered and 25% increased prices (23% were VAT registered from the start). Those who made the majority of their sales to other VAT registered businesses were more likely to be registered from the start (27% were compared with 16% business-to-consumer and 22% mixed sales). As noted in section 3.3, those who made the majority of their sales to other VAT registered businesses were also more likely to have voluntarily registered.

**Figure 7.1: Impact of VAT registration on pricing**



*Base: All voluntary registered (733); All mandatory registered (624) (Don't know/refused excluded voluntary registered = 2%; mandatory registered = 1%)*

Among the other main sub-groups, businesses who use an agent were more likely to keep their prices the same (55% compared with 44% without an agent), while sole traders were more likely to increase their prices (31% did so compared with 23% of companies).

Increasing prices as a result of registering is associated with negative perceptions of VAT. This applies to both voluntarily and mandatory registered: among the mandatory registered 39 per cent of those who have substantial negative views increased their prices compared to 18 per cent of those with no negative perceptions (corresponding figures for voluntary registered were 34% and 18%)<sup>12</sup>. The survey also suggests that increasing prices is associated with prior knowledge of VAT

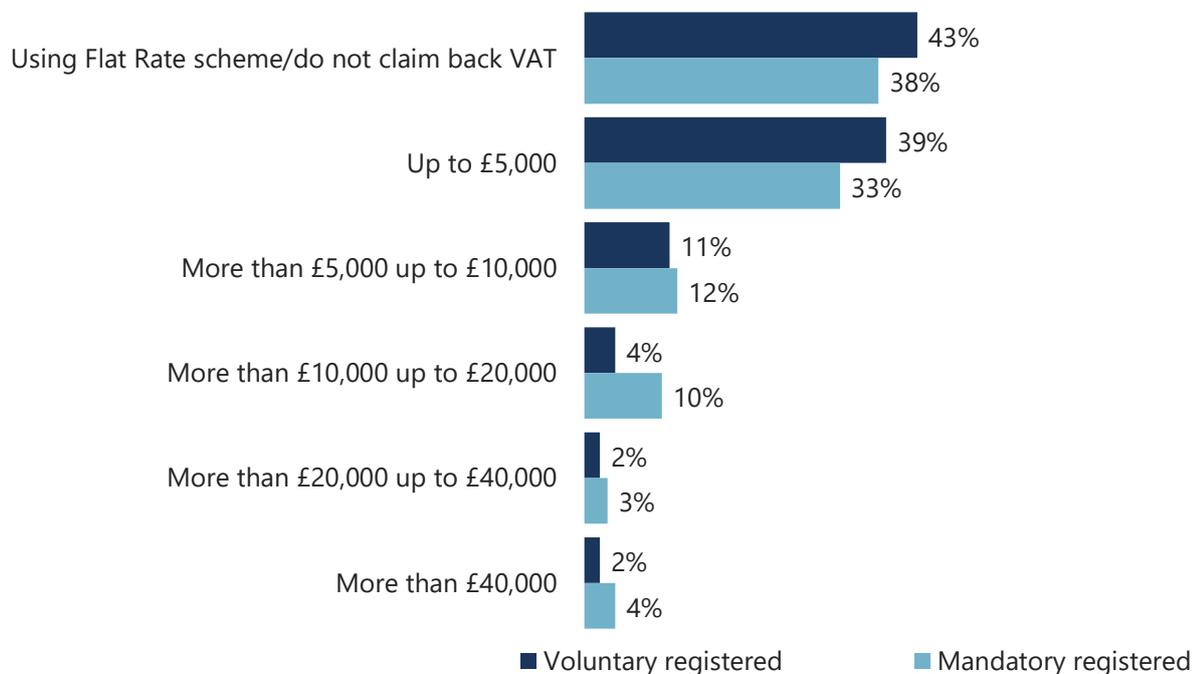
<sup>12</sup> Businesses with substantial negative views anticipated at least two drawbacks before they registered. Those with no negative perception did not anticipate any drawbacks.

– again among the mandatory registered 28 per cent with extensive prior knowledge increased their prices, compared to 14 per cent with some prior knowledge.

Around two-thirds of VAT registered businesses (68%) included VAT in the prices they quote for goods and services; 27 per cent do not and for five per cent it varies. Businesses above the VAT threshold were more likely to include VAT in their advertised prices (73% compared with 64% of those below the threshold) – this again relates to a higher proportion of these businesses selling to consumers.

Figure 7.2 shows the amount of VAT reclaimed in the 12 months after registration among those who were able to provide a figure. Around four in ten businesses said they used the Flat Rate scheme and do not reclaim VAT. Among those that do, most reclaimed up to £5,000. Mandatory registered businesses were more likely to have reclaimed larger sums – 17 per cent had reclaimed more than £10,000 compared to just seven per cent of voluntarily registered businesses.

**Figure 7.2: Amount of VAT reclaimed in 12 months after registration<sup>13</sup>**



Base: All voluntary registered (551); All mandatory registered (451) (Don't know/refused excluded: voluntary registered = 26%; mandatory registered = 26%)

Those with higher business-to-consumer sales were more likely to have reclaimed smaller amounts from other businesses (41% had reclaimed up to £5,000 compared with 35% business-to-business and 38% with mixed sales). The survey also shows a higher proportion of those with mainly business-to-businesses sales had used the Flat Rate scheme and did not claim back VAT in the first 12 months after registration – 47 per cent compared with 28 per cent mainly business-to-consumer and 30 per cent with mixed sales. There were also some differences based on the reasons for registering. For

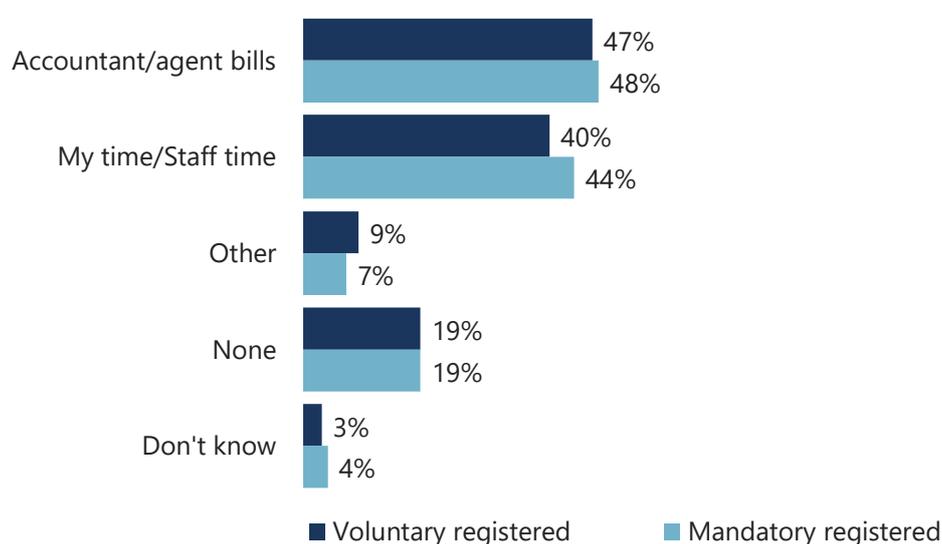
<sup>13</sup> Figures have been prorated for businesses that had submitted three quarterly returns and had only reclaimed for nine months at the time of the interview.

example, 51 per cent of businesses who voluntarily registered for reasons related to helping business growth or image only reclaimed up to £5,000 compared with 39% who registered for financial reasons.

## 7.2 Experiences of record keeping, VAT returns and making payments

As discussed earlier (section 6.3), the possibility of increased administration or paperwork was one of the main concerns that respondents had prior to registration, along with the costs associated with this increased administration. When prompted, around four in five of VAT registered businesses (78%) said they incurred costs in complying with the requirement to keep and maintain VAT records. The most common cost was that of an accountant or agent, which was incurred by around half of businesses. Slightly fewer incurred costs of their own or other staff time. Other costs mentioned included purchasing specialist software packages, storing paper records and computer maintenance. The findings are consistent for both voluntary and mandatory registered businesses, as shown in Figure 7.3 below.

**Figure 7.3: Costs incurred from maintaining VAT records**



Base: All voluntary registered (761); All mandatory registered (644)

Businesses with an agent were more likely to say they incurred costs (80% compared with 67% who undertake their own VAT administration), as did those who account for sales and purchases with manual paper books or manual electronic records (81% and 80% compared with 75% who used a computerised software package).

The qualitative interviews found that record keeping was typically not found to present any serious problems for VAT registered businesses both above and below the threshold. This was generally because businesses were comfortable with VAT administration as a result of receiving advice from their accountant on how to administer it, or because they had previous experience of running a VAT registered business. Where businesses were not comfortable with VAT record keeping, they usually passed it onto their accountant along with the process of submitting the return.

***"I give all of my receipts and my invoices over to the accountant and she deals with paying the VAT and working it all out for me ... It takes the stress away."***

Voluntary VAT registered, Flat Rate

The impact on daily administration of becoming VAT registered was said to be minimal. One typical change was that businesses would add extra columns onto their accounting spreadsheet to record incoming and outgoing VAT.

The main difference noted was that businesses' accounting periods were on a quarterly rather than an annual basis. This aspect, along with having to check VAT returns, did amount to a noticeable increase in administrative burden for businesses that were used to accounting on an annual basis.

VAT record keeping was typically integrated with businesses' record keeping for meeting other tax obligations. Accounts were held on the same systems which were either third party software such as Xero or Sage, Excel files designed by the participants, or a collection of receipts and invoices to be sent to the accountant. There was evidence of record keeping being more time-consuming where businesses used a manual process (in addition to electronic systems). For example, one business reported manually checking all invoices and purchases on an on-going basis and ultimately reading through everything listed in their VAT return to check for mistakes. This process was used to provide confidence that mistakes were not being made and was seen as worth the time if it avoided future problems.

### Case study – Experiences of VAT - Voluntary VAT registered, Cash Accounting

Steven runs a business which builds industrial equipment. He has prior experience of VAT from other businesses and he feels competent to administrate the VAT without the help of external accountants. He uses Sage software to keep track of VAT, to produce VAT returns, and for all other tax obligations.

Steven acknowledges that there is an administrative burden to VAT, particularly checking that the VAT return is correct every quarter, but he sees it as an inevitable part of growing a business.

*"You've got to check your VAT return's correct so we are doing some work as unpaid tax people. But it's just exactly what I knew I was taking on."*

Completing the return takes time out of his working day, but, on balance, he thinks a quarterly return suits him, as it allows him to 'stay on top' of VAT.

*"The less frequent it is the better. But then again, if the period gets too long then it becomes a nightmare. So it's a delicate balance and I would say quarterly is probably about right."*

Simplification schemes were said to have provided administrative advantages and supported record keeping (see section 9). This was particularly noted for the Flat Rate scheme which saved time by avoiding the need for detailed research into which items can be claimed for and at what rate.

## 7.3 Experiences since registering

Having registered, the most common benefit was seen as the ability to claim back VAT from HMRC on purchases from other VAT registered businesses (mentioned by 33% of businesses who voluntarily registered and 27% of mandatory registered without prompting). This was followed by the improved reputation or credibility that it gave the business and the financial and/or tax benefit. Among those mandatory registered three times as many experienced improved reputation/credibility in practice among their benefits as expected it in advance of registering (12% compared with 4%); the increase for those voluntary registered was 15 per cent to 20 per cent. There were similar increases for claiming back

VAT, with it almost doubling for the voluntary registered (18% expected this and 33% said it was a benefit) and almost trebling for the mandatory registered (10% to 27%).

### Case study – Claiming VAT back - Voluntary VAT registered, No scheme

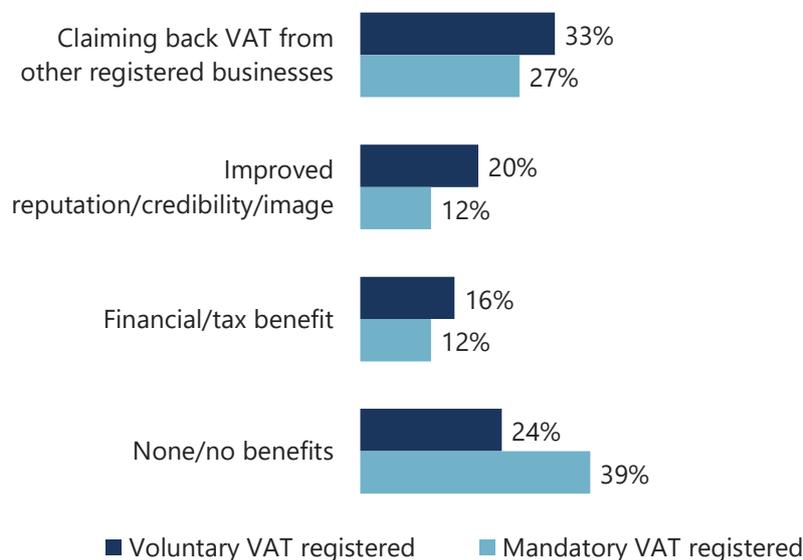
Martin is an electronics engineer who has started his own one-man business. He plans to sell devices to be used in care for the elderly. To manufacture the prototypes, he had to spend a large amount of money buying electronic equipment. One key benefit of voluntarily registering for VAT was that he was able to claim back the VAT he paid on this equipment, allowing him to make considerable savings.

*"There was a big benefit at the beginning for me, it did save me probably a few thousand pounds."*

He plans to sell to other VAT-registered businesses and institutions, and he has prior experience of being VAT registered from previous companies so he did not have any concerns about becoming registered. Martin does not find that there are downsides to being VAT registered, just a slight change to his record keeping.

Around three in ten VAT registered businesses said they had not experienced any benefit, with mandatory registered businesses significantly more likely than voluntary registered businesses to state this. More detail on the types of benefits experienced after registering is provided in Table A.19 in Appendix 4.

**Figure 7.4: Most common benefits since registering for VAT**



Base: All voluntary registered (761); All mandatory registered (644)

Benefits experienced since registration largely reflected initial expectations - most (77%) who registered for financial reasons experienced financial benefits, while around half (51%) of those who registered to help their business grow or improve its image found that in practice this was among the main benefits although the same proportion (50%) of this group also experienced financial benefits.

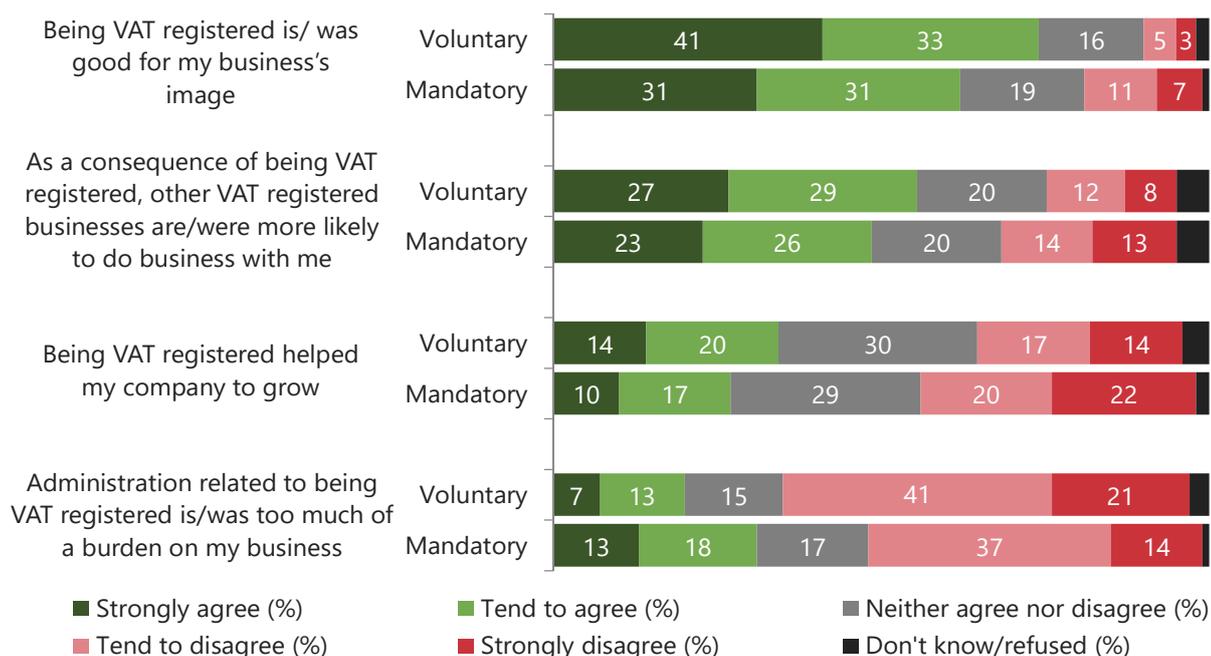
Other key findings among the main sub-groups were:

- Voluntary registered businesses who expected to grow in the next 12 months felt that growth and image has been among the main benefits of registering (31% compared to 18% for both those expecting the business to stay the same or decline);
- Businesses that registered for default-type reasons (for example because their turnover exceeded the threshold) were more likely to think registration had brought them no benefits (34% compared with 14% of other businesses);
- Those who increased prices were more likely to feel that registering has helped business growth or image (28% compared with 18% of those who kept prices the same);
- Voluntary registered businesses using an agent were less likely to have experienced financial benefits – 47 per cent did so compared with 64 per cent of those who do not use an agent; and
- Businesses with higher business-to-business sales were more likely to cite benefits to registration – only 22 per cent saw no benefits compared with 43 per cent of those with mainly business-to-consumer sales and 33 per cent with mixed sales.

When prompted, more businesses tended to be positive about the benefits of registering. While fewer than one in five VAT registered businesses spontaneously mentioned benefits to their image and reputation, around seven in ten when prompted agreed that being registered has improved their business image.

It can also be seen in Figure 7.5 that on balance businesses agreed that being registered made it more likely that other VAT registered businesses would do business with them and disagreed that administration was too much of a burden; they were split however on whether registration had helped business growth. On all measures mandatory registered businesses were more likely to be negative.

**Figure 7.5: Attitudes to VAT registration**



Base: All voluntary registered (761); All mandatory registered (644)

As for the spontaneous benefits cited, business-to-business organisations were more likely to be positive about VAT registration. For example, 75 per cent agreed being VAT registered is good for their business image (compared with 58% business-to-consumer businesses and 72% with mixed sales) and only 19 per cent agreed administration was too much of a burden on their business (compared with 33% business-to-consumer and 39% with mixed sales).

Looking at expectations in advance of registration, those who registered for default-type reasons (e.g. thought they did not have a choice, registered from the start or turnover exceeded the threshold) were less likely to agree that registering had been beneficial. For this group 50 per cent felt that that other VAT registered businesses were more likely to do business with them as a result of being registered compared with 65 per cent of other businesses. They were also less likely to agree that being VAT registered was good for their image (66% compared with 82%) and that it helped their company to grow (28% compared with 43%).

Businesses who registered for other reasons tended to be much more positive – 81 per cent who registered because they thought it would help their business grow or improve its image agreed other businesses are more likely to do business with them (compared with 48% who did not register for this reason). Nine in ten of this group (92%) agreed that in practice registration had been good for their image although most (65%) who registered for other reasons also agreed with this.

As before, there was also a relationship between having negative expectations in advance of registration and more negative attitudes after registration, despite this a substantial proportion of these businesses still had positive views. For example, 45 per cent with substantial negative perceptions agreed that as a consequence of being registered other businesses were more likely to do business with them (although this rises to 56% among those with no negative perceptions).

There also is some association between prior knowledge and views of being registered – 33 per cent with extensive prior knowledge agreed that being registered helped their company to grow, while just 15 per cent with some prior knowledge felt the same. Furthermore, those who currently or have previously owned another VAT registered business tended to have more positive views – for example more disagreed that administration is too much of a burden (65% compared with 55% who had never owned another VAT registered business).

Qualitative findings showed that being VAT registered encouraged more frequent accounting and meant businesses often felt more on top of their accounts as a result. The qualitative research also suggested that businesses typically found that administering VAT was not as demanding as they had anticipated. Businesses reported that by having quarterly accounting periods they were more up-to-date with how their business was doing financially. It also encouraged record keeping on an on-going basis rather than previously, when it could be left until the end of the year. Businesses spoke in general of having to be more 'orderly' and more 'disciplined' in their accounting when they became VAT registered.

***"It means you do your accounting on a three month cycle ... It keeps you up to date with the relevant information that's key to seeing how your business is performing."***

Mandatory VAT registered, Flat Rate

In the qualitative interviews, it was also notable that businesses often found the record keeping required for VAT straightforward, which was not something that had been anticipated by businesses that were new to VAT. Participants with prior experience of VAT, or those using the simplification schemes (especially the Flat Rate scheme) were particularly inclined to find record keeping manageable.

***“Everybody says, ‘Ooh I’ve got my VAT return to do’, and that’s a bit infectious. You think it’s this big horrible something or other .... [But] I just think the record keeping is not a big deal really, and if you can fill in a form you can do a VAT return.”***

Voluntary VAT registered, Cash Accounting

#### **7.4 Drawbacks since registering**

Reflecting initial expectations, the most commonly cited drawback to being VAT registered was the extra paperwork and administration. This was more frequently mentioned by voluntary registered businesses (42% compared with 31% mandatory registered). Other drawbacks related to the financial impact of VAT registration such as the need to increase the prices of goods/services sold, the reduction in profits made, increased costs due to having additional administration related to VAT and having large VAT bills (all more likely to be mentioned by mandatory registered businesses who tend to have higher business-to-consumer sales). For example, total profits being reduced was mentioned by 14 per cent of mandatory registered businesses compared with seven per cent of voluntary registered (those with mainly business-to-consumer sales and mixed sales were also more likely to mention this, 18% and 17% compared with 4% business-to-business). Businesses with high input costs were more likely to cite their prices increasing as the main disadvantage – 20 per cent compared with 14 per cent with medium input costs and nine per cent with low input costs.

Around three in ten said they have not experienced any drawbacks after registering – this is consistent regardless of threshold status.

A breakdown of drawbacks experienced since registering is provided in Table A.20 in Appendix 4.

Findings from the qualitative research suggest that the compiling and checking of quarterly returns is the principal administrative burden, more than the day-to-day record keeping.

One key financial drawback businesses mentioned was finding it challenging to meet quarterly payments. This (largely unanticipated) difficulty arose particularly in cases where the business was vulnerable to cash-flow issues. This occurred in the following instances:

- The cost of VAT was being absorbed, affecting cash-flow;
- The cost of VAT was being passed on to customers, but the business was not keeping a separate account for VAT, and so had been spending VAT (particularly in the case of new start-ups with poor cash-flow); and
- The business had not been paid by their customers in time to cover their VAT bill.

Greater flexibility in making payments was suggested to help businesses facing VAT-related cash-flow issues, for example; allowing businesses to make partial contributions to VAT bills or to delay payments to help avoid pain points.

In the qualitative research, businesses with high business-to-customer sales and low input costs emphasised the financial impact as a drawback of being VAT registered. These businesses were not able to claim back any substantial VAT costs, either because they do not make any substantial purchases or because the goods they bought were exempt from VAT (or purchased from unregistered businesses). These businesses explained that they either had to absorb the cost of being VAT registered, reducing their profits, or pass them on to their customers, affecting their competitiveness. Examples of these kinds of businesses included those selling services to individuals (e.g. tutoring, tradespeople, architects) and those buying ingredients (often zero-rate VAT) and selling to individuals, such as cafés.

## 8 VAT stagger

This section examines the points of the year when the business pays its VAT, also known as the 'VAT stagger'. It looks at which businesses have requested a different VAT stagger, the reasons for this and the extent to which VAT cycles are aligned with record keeping and accounting for other taxes.

### 8.1 Requesting a different VAT stagger

Virtually all registered businesses paid VAT quarterly (98%), the remaining paid monthly (1%) or annually (1%). Normally this tax period starts in January, February or March and businesses tend to pay on a quarterly basis from that point. Businesses can request a different quarterly cycle to the one allocated by HMRC

Most businesses accepted the stagger period they were allocated when they first registered - only five per cent recall ever requesting a different one.

A different quarterly cycle was most often requested to align the VAT accountancy period with other tax obligations (mentioned by 46% without prompting). Businesses also felt changing the stagger period would reduce administrative burden or complexities (14%) or that it generally helped their cash flow (12%). The full list of reasons is provided in Table A.21 in Appendix 4.

Typically businesses who took part in the qualitative research were satisfied with the stagger period they had been allocated or at least were unable to see any clear advantage to changing this. Given the need to file quarterly, it was seen as unlikely that all dates would fall at a 'good' period whatever dates they were set.

More exceptionally, businesses said that different reporting dates would fit better with their accounting. In some instances businesses wanted to synchronise their VAT payments with their tax year, largely for convenience and neatness. Conversely, other businesses felt that pressure on cash-flow would be eased by ensuring that they did not have to pay VAT and other taxes at the same time. Typically businesses were aware that they could change dates, but as this was only likely to provide a very small administrative benefit, this option had not been pursued.

***"Ideally I would like it to tie in with the tax year ... It would just neaten everything up ... I do believe there's a mechanism where I can change it to that cycle if I so wish to, but I haven't investigated that."***

Mandatory VAT registered, Flat rate

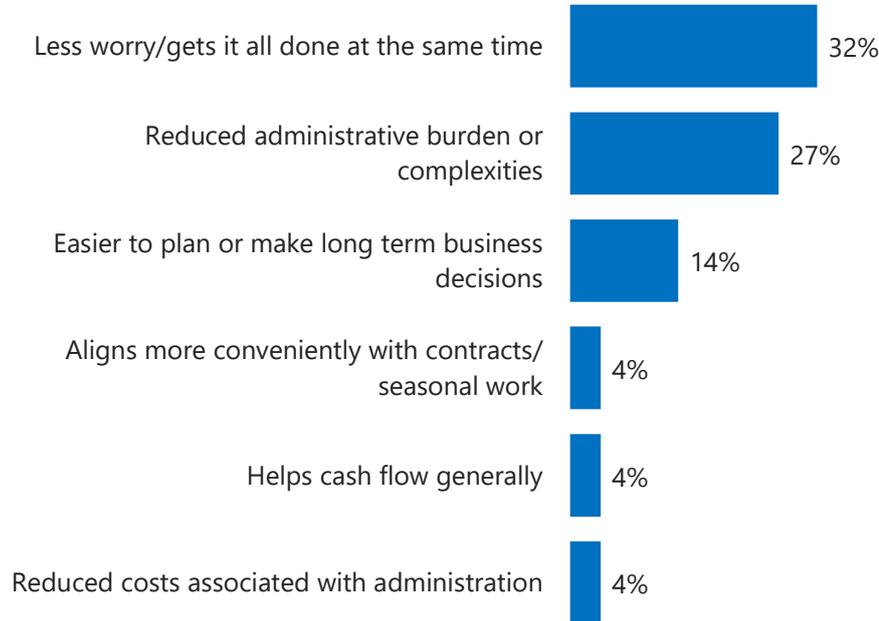
Looking ahead only six per cent of businesses thought it likely they would request a change to their VAT cycle in the next 12 months – the majority (91%) said it was not very or not at all likely and four per cent were unsure whether they would.

### 8.2 Alignment of VAT reporting with Corporation Tax and Self-Assessment

Three-quarters of VAT registered businesses have their VAT reporting aligned with their accounting period for other tax obligations, such as Corporation tax or Self-Assessment (73%). The main benefits of having their reporting aligned were that it reduces worry by getting it done at the same time (mentioned by 32% without prompting) and reduces administrative burden (27%). A further 14 per cent think it is easier for them to plan ahead or make long term business

decisions. Few cite other benefits (a full list is shown in Table A.22 in Appendix 4). Around one in five do not think there are any benefits to alignment.

**Figure 8.1: Most common benefits of VAT alignment with other tax obligations**



Base: All VAT registered businesses who have taxes aligned (884)

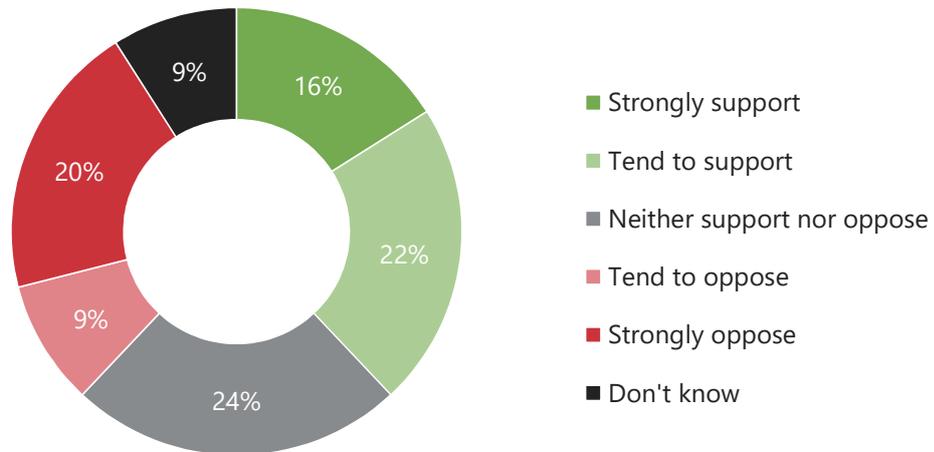
Businesses that voluntarily registered for VAT were more likely to mention both worrying less due to their tax obligations being aligned (35% compared with 27% of mandatory registered) and administrative benefits of doing so (30% compared with 22% who mandatory registered). The reduced administrative burden was also more frequently mentioned by those with higher business-to-business sales (31% compared with 19% business-to-consumer) – who, as mentioned before, were more likely to have voluntarily registered.

Among the one in four (27%) VAT registered businesses whose accounting periods were not aligned, most had experienced no problems with this (75%). For those that did experience problems an increase in administrative burden and additional costs were most commonly cited, as well as generally more worry and difficulties planning ahead (by 10% without prompting for both).

### 8.3 Attitudes towards quarterly Corporation Tax and Self-Assessment reporting

Businesses were told that in the future they will need to update HMRC quarterly in relation to Corporation Tax and Self-Assessment, like they do for VAT.

Two in five (38%) VAT registered businesses would support having quarterly VAT cycles aligned with quarterly cycles for Corporation Tax or Self-Assessment in the future. Three in ten (29%) oppose the idea and a third of businesses (33%) were neutral or do not know if they would support or oppose it.

**Figure 8.2: Support and opposition for aligning quarterly VAT cycles with other accountancy periods**

Base: All VAT registered businesses (1,405)

Support was higher among businesses who mostly sell to other VAT registered businesses (41% compared with 32% business-to-consumer). There were no significant differences among companies or sole traders or by agent usage.

## 9 VAT simplification schemes

This section explores which simplification schemes newly registered businesses are aware of, how businesses decide whether to participate in particular schemes and how well businesses feel the schemes are meeting their needs.

### 9.1 Awareness of schemes

Businesses were asked if they were aware of three VAT support schemes offered by HMRC - the Flat Rate scheme, Cash Accounting scheme and the Annual Accounting scheme. As would be expected, VAT registered businesses were more knowledgeable than unregistered borderline businesses about all three schemes.

Overall businesses were most likely to be aware of the **Flat Rate scheme** (76% of VAT registered and 42% of unregistered borderline businesses had at least heard of it), with almost four times as many VAT registered businesses as unregistered borderline businesses claiming to know *a lot or fair amount* about the scheme (42% compared with 12%).

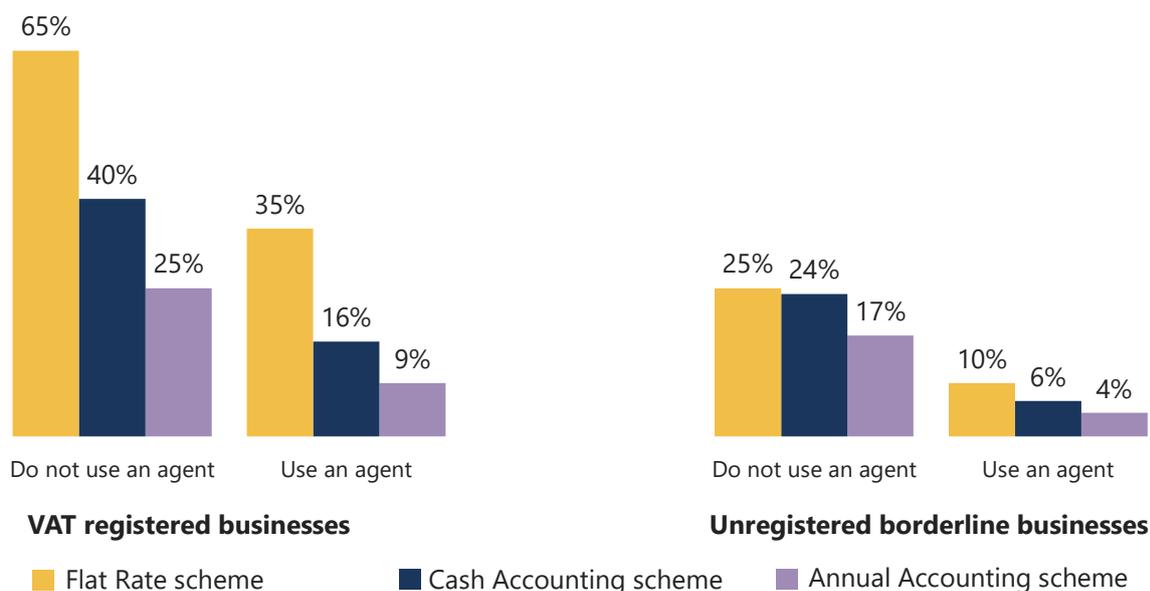
While understanding of the Flat Rate scheme was low among unregistered borderline businesses, this was even lower among unregistered businesses that used an accountant for their tax affairs: three in five (58%) had never heard of the scheme compared with two in five (38%) who did not use an accountant. A similar pattern was evident for VAT registered businesses: those that managed their own VAT administration were more likely to know a lot or fair amount about the scheme (65% compared with 35% who used an accountant). In addition, businesses who mostly sell to other businesses had a greater understanding of the scheme (51% compared with 30% business-to-consumer) as did companies (46% know a lot or fair amount compared with 27% registered sole traders).

While fewer businesses were aware of the **Cash Accounting scheme** (46% of VAT registered and 28% of unregistered borderline businesses), on the whole the sub-group variations mirror those described above for the Flat Rate scheme.

Businesses undertaking their own administration rather than using an accountant were more likely to know a lot or fair amount about the scheme (40% of VAT registered businesses undertaking their own administration compared with 16% of businesses who use an accountant; 24% compared with 6% respectively for unregistered borderline businesses). Business-to-business organisations again had higher levels of awareness – 24 per cent of VAT registered business claimed to know a lot or fair amount compared with 15 per cent business-to-consumer (the figures for unregistered borderline businesses were 11% and 8% respectively). Companies were also more knowledgeable about the scheme: 23% of VAT registered companies knew a lot / a fair amount compared with 14 per cent of VAT registered sole traders.

Businesses were least likely to be aware of the **Annual Accounting scheme** (39% of VAT registered and 30% of unregistered borderline businesses). Twice as many VAT registered businesses knew a lot or fair amount about the scheme than unregistered borderline businesses (12% compared with 6%).

Again, businesses that undertake their own tax administration were more knowledgeable as shown in Figure 9.1.

**Figure 9.1: Proportion of businesses that know a lot or fair amount about each scheme**

Base: All VAT registered businesses (1,405), All Unregistered borderline businesses (604)

The qualitative research revealed that knowledge of simplification schemes tended to be limited to schemes businesses had taken part in or were currently using. For businesses that had largely delegated responsibility for VAT to their accountant (and only supplied them with receipts and invoices) there was particularly low understanding of the schemes.

## 9.2 Sources of information on the schemes

Businesses mainly received information on the schemes from professionals, typically accountants, although some also approached solicitors and Industry Bodies (as shown in Table A.23 in Appendix 4). The next most common source of information was HMRC (including the website). Customers who received information on the Annual Accounting scheme were more evenly split in receiving advice from agents and HMRC (38% and 36%).

Businesses in the qualitative research had typically heard of the schemes from their accountants, who also advised them about whether to take up a scheme or not. Others mentioned they were familiar with the schemes through past experience of running a business and previous employment. Businesses had also seen the schemes referenced in introductory materials on VAT from HMRC. There was typically a desire for more information on the schemes, and wider promotion from HMRC as even participants with several years of experience of administering VAT often felt they did not have a good understanding of the different schemes.

## 9.3 Use of schemes

Around half of all VAT registered businesses had used the **Flat Rate scheme** since registering for VAT (46%).

This was higher among:

- Businesses who sold mostly to other VAT registered businesses (56% compared with 28% business-to-consumer);
- Nano businesses (55% compared with 39% with employees);

- Those that manage their own VAT administration (57% compared with 42% who use an agent);
- Businesses that keep manual electronic accounts (56% compared with 39% who use software and 37% who use paper accounts);
- Those that have been trading for up to 10 years (47% compared with 33% of businesses that have been trading for longer); and
- Businesses that plan to stay the same size in the next 12 months (54% compared with 44% who expect to decline and 39% who want to grow).

Significantly fewer businesses had ever used the **Cash Accounting scheme** (15%). Again, there were higher levels of usage among business-to-business organisations (17% compared with 12% business-to-consumer). However, in contrast to the Flat Rate scheme, those with an agent for VAT administration were more likely to have used the Cash Accounting scheme (23% compared with 13% who do not use an agent), and those who keep accounts on software also were more likely to have used the Cash Accounting scheme (19% compared with 11% paper accounts and 13% electronic records).

Very few businesses had ever used the Annual Accounting scheme since registering for VAT (5%).

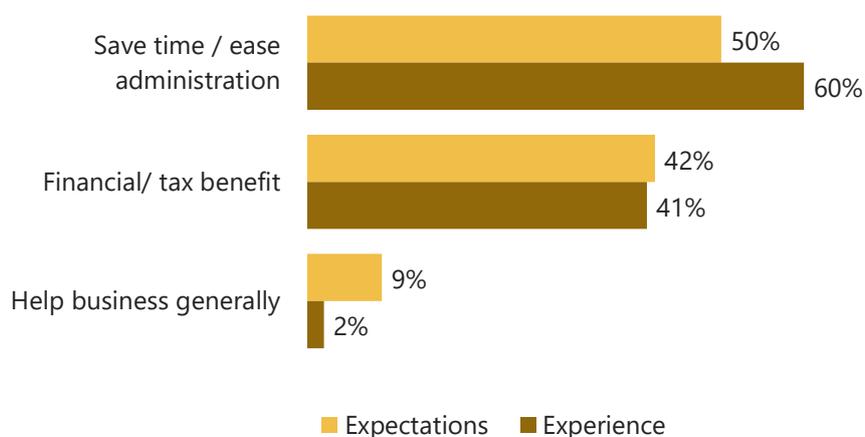
Qualitative interviews discovered that the thought of moving onto a scheme was perceived to be a hassle by some. Therefore the point at which a business registers for VAT was a key window to also join a scheme.

## 9.4 Experience of using schemes

The primary reason for first deciding to use the schemes was the perceived **administrative and financial advantage**. While this varied according to the scheme, the benefits realised after using them were similar to the reasons given, indicating that **benefits experienced were generally in line with expectations** – and in some cases were exceeded. A full breakdown of reasons for using the schemes and perceived benefits is provided in Tables A.24 to A.26 in Appendix 4.

The most common reason for first deciding to use the **Flat Rate scheme** was the expectation it would save time or ease administration and the majority found this was one of the main benefits after using it.

**Figure 9.2: Expectations and experience of the Flat Rate scheme<sup>14</sup>**



Base: All users of the Flat Rate scheme (575)

<sup>14</sup> This chart shows the top reasons banded into themes. For a full breakdown please see Table A.24 in Appendix 4.

The qualitative research revealed **administrative benefits** were typically the primary driver for uptake of the Flat Rate scheme, although businesses with high business-to-consumer sales were primarily motivated by the financial saving. The scheme removed the need to determine the different rates that apply to different categories of goods, which was perceived as the most complex element of VAT. One participant, for example, mentioned that postage and couriers have different VAT rates, citing this as an instance of the kind of complexity they wanted to avoid. The Flat Rate scheme also avoided the need to keep track of how much VAT the business had paid.

***“Obviously what was pretty difficult to wrap my head around was what we were allowed to claim for. But luckily because we chose to go down the route of the Flat Rate, that took that issue out of it.”***

Mandatory VAT registered, Flat Rate scheme

A second administrative benefit was that, by using the scheme, businesses found they did not have to significantly change their record keeping when they became VAT registered. Record keeping was not found to be any different, and calculating VAT was found to be particularly straightforward and amounted to calculating a percentage rate of the turnover figure.

The simplicity of record keeping freed businesses to concentrate on fee-earning activities which was particularly appealing to new start-ups. Businesses also found that the simplicity of the Flat Rate scheme meant they did not have to pay an accountant to administrate the VAT.

Some businesses explained that the fixed monthly payments made for greater continuity in accounting over the year, which helped businesses to plan. The payments also had positive impacts on cash flow, as they were more predictable.

### Case study – Flat Rate scheme, Mandatory VAT registered

Nazia and her husband run a holiday-lets business. In order to grow they took on an existing business which was already VAT registered. Although they had run a business before, it was not VAT registered and they were unfamiliar with the processes involved in running a VAT-registered business.

Nazia chose to use the Flat Rate scheme as it was seen as easier and simpler for her to manage while she became used to running a VAT registered business. Nazia is aware that using the Flat Rate Scheme means she does not ‘get all of the benefits of being VAT registered’ and can’t claim VAT on purchases; however, it was considered a priority for her to have straight-forward administration processes.

*“We’ve gone Flat Rate, we’ve gone with the easy option because we really didn’t know what we were doing, don’t understand it. By being Flat Rate we know where we stand and that suits us.”*

Businesses with high business-to-consumer sales and low input costs had calculated that being on the Flat Rate scheme reduced the cost of VAT, by up to half in some cases, and this was their primary motivation for using it. The qualitative research identified the scheme as being of vital importance for businesses with lower profit margins, who believed that without it their businesses would be unprofitable which could lead them to close.

***[Without the Flat Rate scheme] we would be closing tomorrow. If we had to pay full 20% then that would finish us off completely and we would, we wouldn't even be breaking even, we would be making a considerable loss.***

Voluntary VAT registered, Flat Rate scheme

### Case study – Flat Rate scheme, Mandatory VAT registered

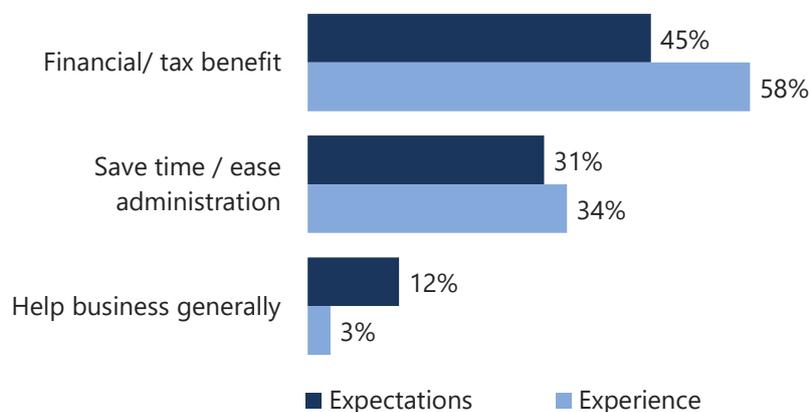
Serena runs a city centre café employing several staff. She had to register her business when she bought it as she anticipated its turnover was going to exceed the threshold in its first year.

Cafés like hers have high business-to-consumer sales, and they cannot claim back substantial VAT as the ingredients they buy are typically zero rated. This means that for Serena, VAT was a direct cost to the business. It is partly absorbed in her profits and she has increased prices. Serena states that the Flat Rate reduces the cost of VAT which provides an obvious financial advantage to her. It also provides an administrative benefit, but this is less of a priority.

*"It's a no brainer to go on a Flat Rate scheme – we were inside the boundaries of that, so we've got to, because the rate's lower."*

Businesses that have used the **Cash Accounting scheme** said the main reason was the financial and tax benefit<sup>15</sup> and more businesses using the scheme experienced this than the percentage that originally anticipated it (58% compared with 45%).

**Figure 9.3: Expectations and experience of the Cash Accounting scheme<sup>16</sup>**



Base: All users of the Cash Accounting scheme (182)

The primary reason given in the qualitative research for using the Cash Accounting scheme was financial; businesses found that it improved their cash flow when the business' invoices were not paid on time. Cash Accounting was also reported to provide an administrative benefit because it was more straightforward and intuitive as the business' accounts were identical to the business' bank account.

<sup>15</sup> This is a grouped code where other codes of a similar theme are banded. The codes included in 'financial and tax benefit' are: provides a financial benefit to the business; tax benefit to using the scheme; pay less tax and reduced need for accountant – saved money that way.

<sup>16</sup> This chart shows the top reasons banded into themes. For a full breakdown please see Table A.25 in Appendix 4.

***“I only pay VAT on what I collected and I only reclaim VAT on what I paid, rather than basing it on invoices which would just be an extra thing to keep tabs on and an extra complication and an extra area of risk of making a mistake.”***

Mandatory VAT registered, Cash Accounting

### Case study – Cash Accounting Scheme, Mandatory VAT registered

Tony’s business specialises in mechanical and electrical systems for buildings. Business is going well and invoices are sometimes worth several hundred thousands of pounds.

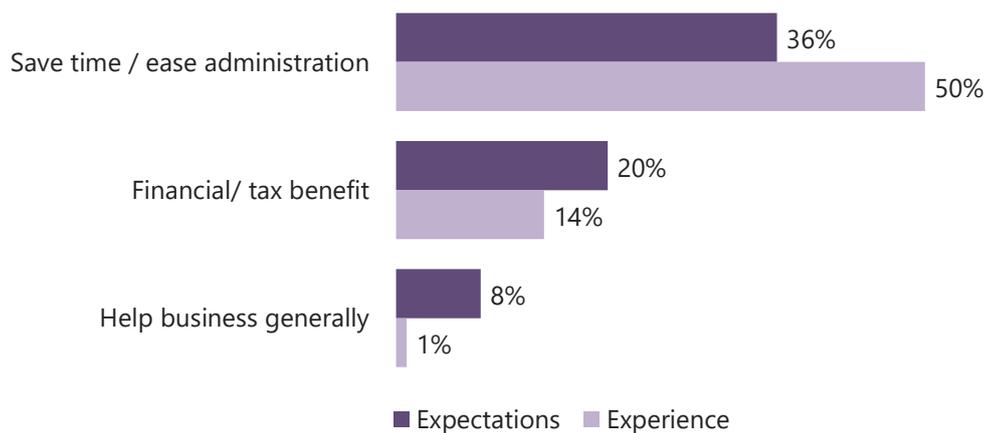
Tony uses the Cash Accounting scheme. This means Tony does not have to pay out VAT on invoices which are not paid on time (which happens frequently). He also sometimes works with a public sector organisation who are not invoiced until the contract is complete – without Cash Accounting this would present serious issues for Tony’s business.

*“You can be waiting 4 months before you actually get paid ... so it’s much better basically paying the VAT on cash receipts.”*

Tony requests that the threshold for the scheme be increased to allow his business to carry on using it as it grows, as he thinks the cash-flow issues he faces will always be there due to the nature of his work.

The most common reason for first deciding to use the **Annual Accounting scheme** was the expectation it would save time or ease administration, and again a higher proportion of businesses experienced this compared with what they originally expected (50% and 36%).

**Figure 9.4: Expectations and experience of the Annual Accounting scheme<sup>17</sup>**



Base: All users of the Annual Accounting scheme (134)

<sup>17</sup> This chart shows the top reasons banded into themes. For a full breakdown please see Table A.26 in Appendix 4.

The Annual Accounting scheme was reported to have both **administrative and financial advantages** in the qualitative research. Most businesses commented that administratively, it meant that businesses were only required to submit one VAT return a year (rather than four) which reduced the burden.

***“I’m quite lucky that I only have to go through the rigmarole once every 12 months. I’m quite grateful that I don’t have to do it quarterly.”***

Voluntary VAT registered, Annual Accounting

Some businesses explained that the fixed monthly payments made for greater continuity in accounting over the year, which helped businesses to plan. The payments also had positive impacts on cash flow, as they were more predictable.

### Case study – Annual Accounting scheme, Voluntary VAT registered

Ajay is an IT contractor working in data security. He registered his business voluntarily, based on his accountant’s advice, as his turnover was quickly going to exceed the threshold. He does his own VAT administration, and uses the Annual Accounting scheme, again on the advice of his accountant. The scheme simplifies his administration by relieving the need to do VAT accounting quarterly.

Ajay is aware that his payments are based on the previous year’s turnover. Whilst he is still growing, this doesn’t present an issue, although he notes that if his business reduces, the payments could potentially become unaffordable.

*“It’s fine at the moment but could become an issue, if my turnover drops I’d still be paying VAT on last year’s figures.”*

## 9.5 Reasons for not using the schemes

The main barrier to using the simplification schemes was **lack of awareness or knowledge** about the schemes (31%). Businesses who were less knowledgeable were more likely to sell to a mix of businesses and consumers (42% compared with 31% of business-to-consumer and 28% of business-to-business) and use an accountant (33% compared with 19% who do not use an accountant).

A further one in five did not use the schemes due to reasons associated with accountants and agents, such as an accountant advising them not to use the schemes, or alternatively they did not have an accountant to advise them on the schemes. A small number of businesses said they did not trust HMRC or found the information provided by HMRC unclear, wanted to keep control of the business and administrative processes, or found the scheme did not provide sufficient cash savings to the business. A full list of reasons for not using the schemes is provided in Table A.27 in Appendix 4.

In the qualitative research, lack of awareness and understanding was a key reason for non-take up of the schemes. Specifically, businesses were unsure of how the schemes worked, the eligibility criteria (e.g. turnover) and also lacked the time to investigate.

For the **Flat Rate scheme**, some businesses with a very good understanding of VAT had calculated that, on balance, it would be financially preferable not to use the scheme. This was often due to their ability to claim back VAT on purchases.

Businesses with a steady cash flow – for example due to regular subscription payments – felt no need to make use of the **Cash Accounting scheme**. There were also businesses that viewed Cash Accounting as an over-complication, as they predicted they would have to keep track of two systems: the accrual accounts and the cash accounts. In addition, they felt there were benefits to accrual or ‘standard’ accounting; that the details of what is going on the VAT return are already established, whereas with cash accounting, businesses sometimes had to investigate what the payments they had received related to.

***“Standard accounting is actually better ... with standard accounting you know each individual invoice, supplier or sales invoice is actually on the VAT return ... It’s better from the admin point of view because, with the cash accounting through Sage you do lose a bit of vision of what’s actually going on. It’s not so simple to understand.”***

Voluntary VAT registered, Cash Accounting

Moving on to Cash Accounting was certainly felt to be financially preferable for businesses whose invoices were not always paid on time. However, some businesses chose not to because it was felt the transition would cause too much disruption to their accounting systems.

The qualitative research suggested the fixed monthly payments in the **Annual Accounting scheme** based on the last year’s turnover presented issues for businesses with more variable income. These businesses found that the payments did not always match the natural peaks and troughs of a business’s finances, meaning businesses could be faced with substantial monthly VAT bills even after a quiet trading period. There was an example of one business that previously used Annual Accounting moving back to quarterly payments for this reason.

There was also the risk that if a business was growing there was a need to keep track of how much VAT would be due for the next year, otherwise they could easily go into arrears.

***“I don’t want to be paying sums of money which are like forecasts to the Government and then having to claw it all back. It’s just disrupting.”***

Voluntary VAT registered, Cash Accounting

Not being on the scheme could also help with cash flow: if, for instance, a business had made a large purchase, the business may prefer to reclaim VAT as soon as possible, which, it was believed, was not possible on the Annual Accounting scheme.

## 9.6 Improvements to current schemes and changes to the VAT system

Two-thirds of VAT registered businesses think the current schemes offered by HMRC for VAT support meet their business needs very or fairly well (67%). Moreover, when asked how future schemes could address their needs, a substantial proportion (42%) did not feel the schemes could be improved. Just over half of unregistered borderline businesses (53%) also had no suggestions with most feeling the schemes were simply not relevant to them.

Suggested improvements to the schemes from the **qualitative research** were:

- Increasing the limit for the Cash Accounting scheme above £1.35 million to allow growing businesses to continue to use it;

- Being able to adjust or postpone the Annual Accounting scheme monthly payment to avoid cash-flow pain points;
- More accessible information for the Flat Rate Scheme on the level of VAT rate their business would be eligible for, as well as improving accessibility of information in the Flat Rate scheme on how to submit a VAT return; and
- Increasing the turnover threshold at which you must come off the Flat Rate scheme from £230,000 to £500,000 – a particular request from those with high business-to-customer sales, for which the Flat Rate scheme provided a considerable saving.

## 9.7 Suggestions for future schemes

Where businesses made suggestions for **future schemes**, improving guidance and simplifying complicated processes were most important.

### Improve HMRC guidance and information

One in ten businesses suggested improvements are needed for **HMRC guidance or information** (11% for both VAT registered and unregistered borderline businesses). Businesses also felt HMRC should **provide more bespoke or tailored support or advice** (7% for VAT registered and 4% for unregistered borderline businesses).

The qualitative research suggests whilst the general information and guidance on VAT was typically found to be satisfactory, businesses did comment that some specific information was difficult to find, in particular:

- How to determine the different rates and exemptions for different goods and services;
- What Flat Rate a business could expect given its sector; and
- How to submit VAT returns, in cases where the scheme would affect which figures are submitted.

Webinars or holding face-to-face forums for local businesses were suggested, as well as demonstration videos on how to complete a VAT return.

Businesses were keen to access tailored support from HMRC that went beyond the more widely applicable support for all businesses on the gov.uk website. Businesses emphasised that sometimes they had gone as far as they could with guidance available online, and yet still had queries for HMRC about VAT. Greater availability of experienced call centre staff and online web chat support were suggested. Being assigned a personal advisor, if required, was also requested.

### Simplify the system

Simplifying complicated processes was also suggested for improving future schemes: nine per cent of VAT registered and six per cent of unregistered borderline businesses mentioned simplifying processes for registering or submitting tax returns, while seven per cent of each group suggested tax rules should be simplified.

In the qualitative research a key simplifying suggestion was removing different VAT rates and exemptions and settling on one (lower) rate across all goods and services.

***"The tax rules are so complicated ... is it simpler just to say let's have a bit of VAT on everything, cut out all the rules and the books and the manuals and basically if you buy a service then you pay 2% or 3% tax on it, full stop?"***

Voluntary VAT registered, Cash accounting

The option to have a scheme in which the VAT period was monthly rather than quarterly was also advocated. Businesses saw the advantage of this being smaller VAT payments, which would vary with latest turnover, and so would better match cash flow. To avoid a proportional increase in administration in submitting monthly returns, it was envisaged that a software tool, equivalent to the Real Time Information system used with PAYE, could be used to automate VAT payments.

Again, determining the different rates and exemptions for goods and services was the primary area which was felt to be too complicated, in particular for international and EU sales.

***“[There are] uncertainties, there are lots of rules about things you can reclaim and can’t reclaim and it’s obviously, presumably there is just a big huge long list somewhere ... the complications make it difficult for small businesses to understand and learn about and therefore do correctly.”***

Mandatory VAT registered, Cash accounting

One radical suggestion was to abandon VAT altogether and to simply increase other taxes such as self-assessment and corporation tax.

## 10 Experiences of deregistration

This section examines experiences of deregistration and plans to deregister in the future.

### 10.1 Ownership of VAT registered businesses

The majority (71%) of VAT registered businesses have never owned another business registered for VAT. One in ten (10%) currently own another VAT registered business and one in five (20%) have previously owned one.

Seven per cent of unregistered borderline businesses currently own another VAT registered business and 15 per cent have previously owned one. For one in eight (13%) the business they were responding on behalf of in the survey was previously registered. Two-thirds (66%) have never owned a VAT registered business.

### 10.2 Experiences and expectations of deregistering

Around seven in ten (69%) unregistered borderline businesses that have owned a VAT registered business in the past have been through the process of deregistration (22% of unregistered borderline businesses overall).

Six per cent of VAT registered businesses are planning to deregister the business they were responding on behalf of in the survey in the next twelve months.

### 10.3 Reasons for deregistering

Respondents who claimed to have deregistered, or were planning to do so, were asked for the reasons for this. For VAT registered businesses, the most common reason was that the business is declining or being wound down (mentioned by 75% without prompting).

Unregistered borderline businesses most frequently cited the turnover of the business not reaching the VAT threshold (53%), although a substantial proportion also said the business was declining or closed down (37%). There were also some responses related to tax and administration: 14 per cent of unregistered borderline businesses cited financial reasons and the tax burden, while a further four per cent of this group said it related to the administrative burden of VAT registration.

**Table 10.1: Reasons for deregistering**

	VAT registered	Unregistered borderline
<i>Base: All businesses who are planning to deregister/have deregistered a business</i>	86	129
Registering is no longer relevant/business is declining	75%	37%
Didn't qualify/reach the threshold	25%	53%
Change of personal circumstances	8%	7%
Financial reasons/tax burden	4%	14%
Administrative burden	0%	4%
Registering didn't have the benefits I'd hoped for	0%	1%
Other	6%	7%
Don't know/refused	8%	4%

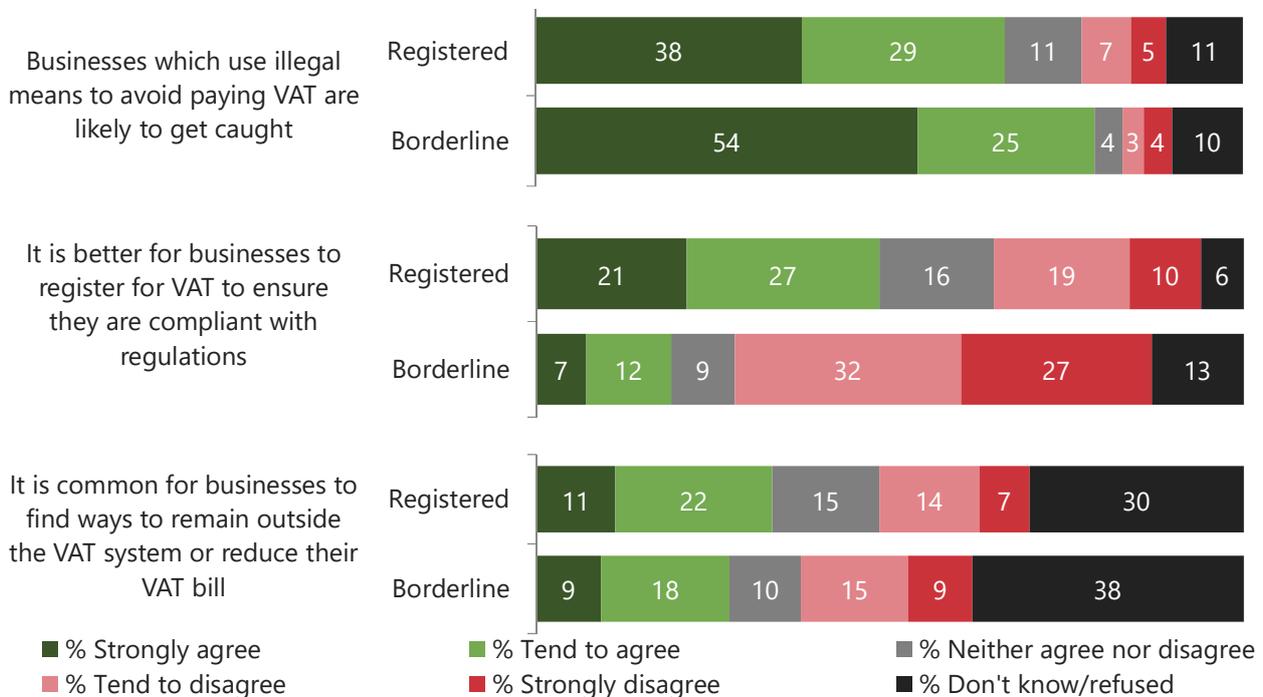
# 11 Restricting business activities

This chapter explores attitudes to the VAT system, the types of businesses that purposively restrict business activities to remain below the VAT threshold, their main reasons for doing so and how they ensure they remain below the threshold. It also examines how growth and VAT registration might be stimulated in these businesses.

## 11.1 Attitudes on the VAT system

The majority of businesses agree that *businesses which use illegal means to avoid paying VAT are likely to be caught*. Unregistered borderline businesses are more likely to agree with this statement, as indicated in Figure 11.1.

**Figure 11.1: Business attitudes on the VAT system**

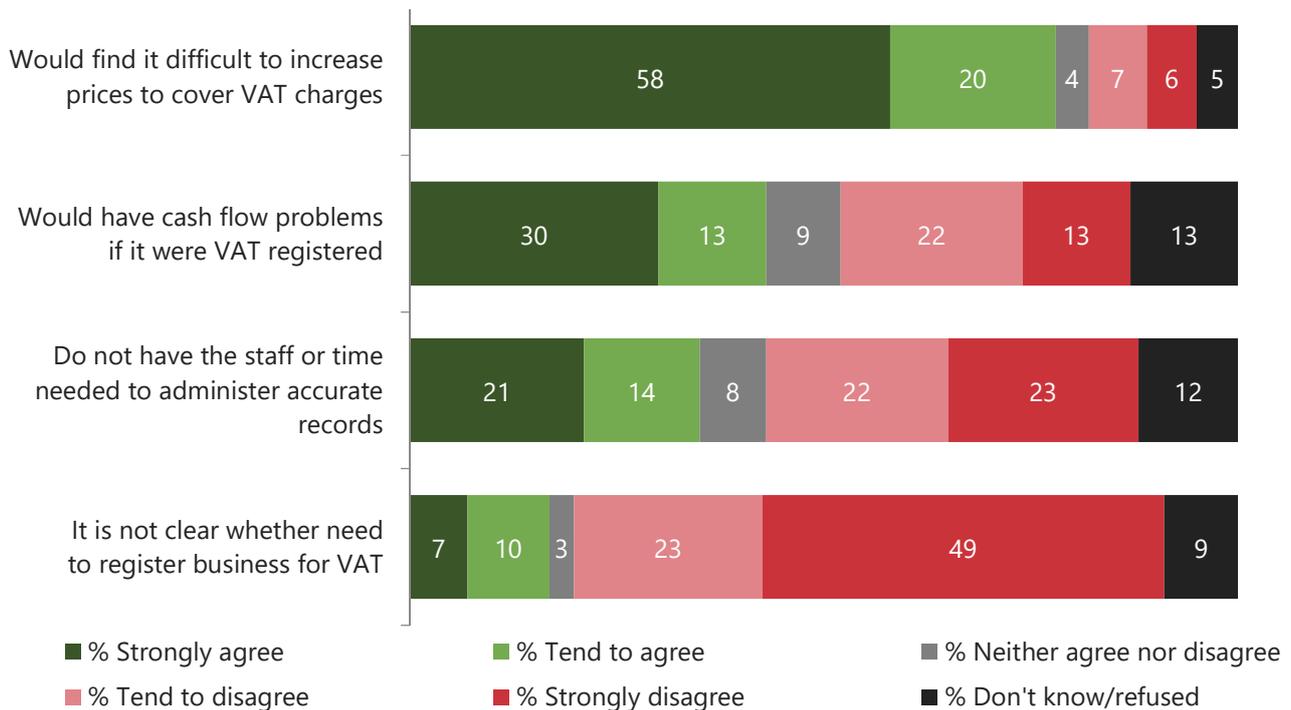


Base: All VAT registered businesses (1,405), All unregistered borderline businesses (604)

There was less consensus about whether *businesses should register for VAT if their turnover is under the threshold to ensure they are compliant with regulations*. Unregistered borderline businesses were less likely to think this precautionary measure is necessary (only 19% agreed compared with 53% of voluntary registered and 40% mandatory registered). Among registered businesses, those with an agent were more likely to agree (52% compared with 36%).

Businesses were most divided on whether *it is common for businesses to find ways to remain outside the VAT system or reduce their VAT bill*. At least three in ten in each group were unable or unwilling to give an opinion.

Most unregistered borderline businesses agreed they would *find it difficult to increase prices to cover VAT charges* (78%), as shown in Figure 11.2. Two in five expected problems with cash flow if they were to register and a third felt they did not have the staff and time to administer accurate records for VAT. One in five were not clear on whether they needed to register for VAT.

**Figure 11.2: Unregistered borderline businesses attitude to VAT registration**

Base: All unregistered borderline businesses (604)

Unregistered borderline businesses were more likely to perceive barriers if they used an accountant for their tax affairs – for example, only 12 per cent disagreed they would find it difficult to increase prices compared to 21 per cent who manage their own administration.

Businesses who admit to restricting their turnover were more likely to be clear on whether they need to register their business for VAT (80% compared with 70% of other unregistered borderline businesses), and were more likely to agree they would find it difficult to increase prices to cover VAT charges (88% compared with 76% of other unregistered borderline businesses).

In the qualitative research, businesses that were restricting tended to view this as common practice among businesses in their sector and a natural response to the tax system. It should be noted that this was not identified as related to particular sectors, but examples included cleaning and building sectors. There was evident frustration from businesses, who argued that the VAT system was not well designed to accommodate service industries. The system was felt to disincentivise growth among service companies, which was believed to have wider impacts on the economy. It was emphasised that restricting business growth had broader implications, as it also restricted employment, trade, services being provided, tax revenue, and all the other benefits of a flourishing economy.

***“The problem is with my business is that it doesn’t fit neatly into any of the VAT categories...The closest that I found was... the margin scheme that auctioneers use, but I’ll be honest, I’m not fully up to speed on the different schemes. [We were thinking about becoming VAT registered] towards the end of last year because we were thinking potentially that we could be making a lot more money, and pushing the business bigger, but it [VAT] just seems so mind-blowingly complicated that it hasn’t happened.”***

Unregistered borderline business, legal restricting activity

Queries were also raised about why VAT operated on the entire turnover of a business, which resulted in a sharp financial impact for businesses with high business-to-consumer sales and low input costs, rather than on the amount of turnover that was over the threshold, which would have a more gradual effect.

***“If I went above it [the threshold] at the moment I’d be most unlikely to go more than say ten grand above it ...and 40% of that would immediately go in tax and a chunk more of it would go in the costs of having to actually get somebody to do it all for me and the net result would be doing another month’s work or something for no real, for very little actual profit.”***

Unregistered borderline business, Legal restricting activity

## 11.2 Restricting turnover to remain below the VAT threshold

Overall, 20 per cent of unregistered borderline businesses admitted to having taken some action to remain below the threshold. These businesses are more likely to plan to stay the same size rather than grow in the next 12 months (23% compared with 15%) and have higher business-to-consumer sales (22% compared with 13%) who as seen earlier are concerned about the financial impact of registration. There were no significant differences by business size, agent usage or length of trading.

Businesses admitted to restricting their turnover in several different ways:

- Closing the business/stopping advertising. Closing the business for a period of time (e.g. part of the week, month or year) was the most common approach to remain under the threshold (47% of all those restricting their turnover). This was found to provide an opportunity for holidays but could also be a frustrating hiatus for businesses we spoke to in the qualitative research;
- Refusing or turning down work (21%). Depth interviews with these businesses found that turning down work could cause a company some embarrassment, impact on general competitiveness, and risked harming customer relationships;
- Asking their customers to purchase the materials (16%). The qualitative research found that this was seen as a sensible approach to avoiding reaching the threshold too quickly, although some tradespeople limited requests to do this to friends and family only, to avoid any impact on their wider reputation;
- Reducing prices of products to a rate which ensures the VAT threshold is not reached (10%);
- Monitoring accounts to ensure the threshold is not exceeded (7%);
- Splitting the business (10%). This included operating separate legal entities (6%), and artificially separating their business by product service or type (4%). The qualitative research found this was usually on the advice of their accountant. One participant had four different businesses, and was moving income between the business accounts in order to create the impression that all four businesses were below the VAT threshold;
- Excluding one-off contracts which are not part of their usual work pattern (6%) from their financial reporting to ensure they do not exceed the threshold;
- Generally making efforts not to grow the business (6%);

- Taking undeclared cash in hand (1%). The qualitative research identified a small number of businesses taking cash in hand and not declaring it to HMRC, an approach which was described by one such participant as 'common practice' among tradespeople;<sup>18</sup>
- Delaying jobs or payments (1%). The qualitative research found that businesses had various ways of ensuring that income did not exceed the VAT threshold in a given 12 month period. Some requested that payments be delayed, others split their invoices. In one instance a building company asked that the work itself be done later in the year. This company had loyal customers who were prepared to wait and who appreciated the business' non VAT status;
- Other activities (8%). One in ten of those restricting turnover gave other reasons outside of these main reasons in the quantitative survey which covered a variety of different activities such as not taking on more staff or acting on accountants' advice.

### Case study – Illegal restricting activity, Unregistered borderline business

Roger is a tree surgeon. Because he sells services to members of the public, becoming VAT registered would have a clear financial impact on his business, and he predicts he would have to raise his prices.

*"The old lady down the road who wants her tree cut down doesn't want to pay another 20%."*

To avoid having to register for VAT, Roger has taken two approaches. He has created another company, on the advice of his accountant, and he has been taking cash in hand without declaring it. He estimates that his real turnover is about double the VAT threshold.

For Roger, becoming VAT registered would either make him less competitive, in a competitive field, or would reduce what he sees as his already relatively low profit margin. He wishes that VAT was based on profit, rather than turnover.

*"[The threshold] is not a lot when you're trying to run a business – more money goes out than comes in."*

Restricting business activities involved considerable effort and monitoring of turnover, and turning down work could negatively impact on the business' reputation. Some businesses accordingly felt frustrated that they were not able to grow without incurring what they saw as a serious financial impact.

<sup>18</sup> Although we also encountered very diligent recording and reporting among tradespeople.

### Case study – Legal restricting activity, Unregistered business

Sharon sells vintage and antique items at markets and online. Sharon is deliberately staying under the VAT threshold by not attending fairs or updating her website at certain times of the year. Occasionally potential customers will approach her and, to stay under the threshold, she tells them has no stock even when this is not true.

*"To date I have ensured that the turnover level is under the VAT limit deliberately, to the point that I actually stop working most years for a certain amount of time."*

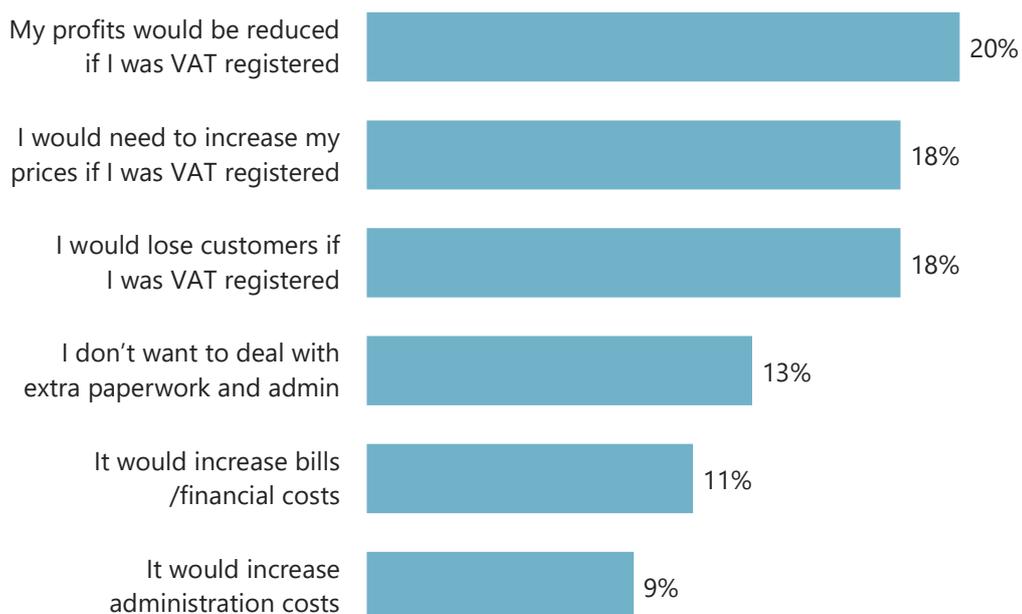
Sharon finds it embarrassing and frustrating limiting her business in this way. Sharon manages her own accounts and has looked into becoming VAT registered on the HMRC website. However, she found the different schemes complicated and confusing and was unable to see which scheme would be best for her business so has not taken this any further.

Sharon has a perception that being VAT registered would cause additional administrative burden and financial loss. Sharon sources items from individuals who are not VAT registered, so would be unable to claim back VAT and increasing her prices would make her less competitive.

## 11.3 Reasons for wanting to remain below the threshold

Businesses that had taken at least one action to ensure their turnover remained under the threshold were asked the reason for this. The most common responses related to the perceived financial impact of registering as shown in Figure 11.3.

**Figure 11.3: Top reasons for remaining below the threshold**



Base: All unregistered borderline who have taken action to remain under the threshold (146)

Businesses with a higher proportion of business-to-consumer sales and low input costs from VAT registered businesses cited the substantial financial impact of VAT registration as the primary reason for restricting growth in the qualitative research. For these businesses, it was said that becoming VAT registered would have a negative impact either directly on their profits or, if the cost was passed on to their customers, on their competitiveness.

***“If I was VAT registered, and then the customers gets two or three quotes, and other people aren’t VAT registered, I’m just not going to get the job because that’s 20% extra on top of the job.”***

Unregistered borderline business, Illegal restricting activity

Secondary reasons for not registering included a general lack of understanding and the perceived burden of extra paperwork. There were also participants in smaller businesses who were currently focussed on running their business and did not have sufficient time to look into registering for VAT, although they were potentially interested in doing so.

***“I’ve spoken to people who have been VAT registered in the past; a complete and utter nightmare. Very burdensome.”***

Unregistered borderline business, Legal restricting activity

More exceptionally, being VAT registered was associated with increased scrutiny from HMRC. In one instance a participant recalled an experience of a VAT inspection at a previous business, where an error had been discovered, and they had been asked to check through the entire accounts – an experience which had put them off being VAT registered.

Some businesses predicted that they would not grow considerably, and so preferred to stay out of the VAT system as they did not want to change their accounting systems. One particular example of this was participants who were soon to retire. In such cases the participants were planning on winding down the business rather than growing it.

The qualitative research also revealed several businesses that were now over the threshold who had previously been restricting their turnover. After a number of years of restricting, these businesses had in the end decided to try to reach their growth potential. Going over the threshold required them to either absorb the cost (sometimes directly affecting the owner’s personal finances) or pass the cost on to customers, reducing their competitiveness.

Businesses had been advised by accountants that they should ‘blast’ through the threshold and not ‘trickle’ through to avoid being financially worse off – but found that this was difficult to achieve in practice. This was because growth typically required financial investment, such as taking on a new member of staff, making it harder for the business to cover VAT payments at the same time.

***“At the moment the business is artificially stagnating if you like because I have to stop working, which is quite nice in some ways, but the only way that I can increase my income at the moment is to increase the profit margin, whereas obviously if I could burst through the VAT limit then potentially the sky is the limit.”***

Unregistered borderline business, Legal restricting activity

## 11.4 Help and advice regarding actions

The survey revealed just over a quarter (27%) of unregistered borderline businesses that restrict their turnover have received help and advice to ensure their turnover remains below the VAT threshold. Only four per cent who do not restrict their turnover have ever received help and advice on this.

Most of those that restricted their activity and had taken advice on this received paid advice (70%), such as information from an accountant or solicitor, and a third (32%) received unpaid advice, usually from a friend or family.

The qualitative research found that participants who had taken advice from an accountant on how to restrict their business were under the impression that their actions were therefore legal, despite their avoidance of VAT sometimes requiring quite artificial measures, such as splitting the business by service type.

### Case study – Complex restricting activity, Unregistered borderline business

Donovan works as a chef. The venue that he works at provides bar snacks but also holds larger catering events. Donovan has a very limited understanding of VAT and everything relating to tax goes to his accountant, in plastic bags of invoices and receipts.

*"I totally rely on my accountant."*

Donovan's accountant suggested to him that he split his business in two: one for the restaurant/catered events and one for the bar snacks, even though both are based out of the same kitchen. Donovan was happy to describe this arrangement and did not feel that there was anything untoward going on.

For Donovan, becoming VAT registered is associated with financial loss, as he can't claim back on food, and he would have to charge his customers more, which would make him less competitive and the venue wouldn't like it.

## 11.5 How unregistered business could be encouraged to grow and join the VAT system

The qualitative findings provided several measures, including full redesigns of the VAT system, to reduce the financial shock for businesses with high business-to-customer sales and low input costs from other businesses. Underlying these suggestions was the aim of minimising the disincentives to growth associated with VAT. There was also a strong desire for a level playing field – businesses wanted VAT registration not to leave them at any disadvantage compared to non-registered competitors.

Suggestions in the qualitative research included:

- HMRC could cover 50 per cent of the cost of VAT on registration, gradually reducing to 25 per cent and 10 per cent as turnover increased, or over time;
- Replicating the income tax system so businesses would only pay tax on the portion over the threshold, not the entire turnover;
- Sector differentiation so that sectors with high business-to-consumer sales and low input costs would have a higher threshold (or lower rates). For example, one participant pointed out that in France service-based industries have a higher threshold than product-based industries. Removing VAT altogether for these industries was also suggested;
- Having the VAT system based on profit, as turnover alone was not a good measure of a company's health; and

- Businesses could be required to charge VAT on all sales - effectively lowering the threshold to zero - to avoid ever having to encounter the VAT 'barrier'.

A common alternative suggestion was simply increasing the VAT threshold. This was seen as the most effective way to encourage businesses to grow, as it sidestepped the need for businesses to become drawn into the VAT system, which for some businesses was almost inherently associated with financial loss and administrative burden. Around £150,000 was proposed as a threshold that would allow businesses who were currently restricting a clear window of growth.

It should also be noted that lack of awareness of the current system could be holding back registration in some cases. A few businesses were unsure whether VAT registration was appropriate for them, and wanted to discuss their situation with someone from HMRC. This prompted suggestions for improved website and phone support; providing businesses with expert advice tailored for their specific needs.

## Appendix 1: Sample outcomes

A stratified random sample of 16,326 leads was drawn by HMRC from VAT administrative records (for businesses that are registered for VAT) and Self-assessment and Corporation Tax records (for unregistered borderline businesses).

The sample was selected randomly to populate strata provided by Ipsos MORI. For both VAT registered and unregistered borderline businesses, the samples were designed to be representative of the population of incorporated companies and sole proprietors/partnerships, although Annual Accounting scheme users in the VAT registered group were purposively over-represented to make up for their relatively low incidence within the representative population as they were of interest to the study.

Around four in ten of the records received from HMRC had phone numbers (6,851), so tele-matching, using publicly available data provided by UK Changes, was conducted on the whole sample. This provided an additional 2,409 leads with phone numbers. These 9,260 businesses were sent an advance letter before fieldwork began, asking if they wished to opt out of the study.

Following the opt out, 8,652 sample leads with phone numbers were available for interviewing. A breakdown of the sample used and response rate achieved is outlined below.

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

	All sample		Valid sample <sup>19</sup>	
	N	%	N	%
Complete interviews	2,009	23	2,009	40
Refusals (including abandoned interviews)	1,622	19	1,287	25
Screened out (unregistered borderline not private sector or selling goods/services exempt from VAT)	528	6		
Unresolved <sup>20</sup>	1,839	21	1,459	29
Not available in fieldwork period	395	5	313	6
Bad numbers	2,259	26		
<b>Total sample</b>	<b>8,652</b>	<b>100</b>	<b>5,068</b>	<b>100</b>
Ineligible (screen out/complete + screen-out))		21%		
<b>Co-operation rate (complete/(complete + refusal))</b>		<b>55%</b>		
<b>Unadjusted response rate (complete/all sample)</b>		<b>23%</b>		
<b>Adjusted response rate (complete/valid sample)</b>				<b>40%</b>

<sup>19</sup> Taking into account ineligibility rate of 21%.

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

## Appendix 2: Weighting approach

The first step in Ipsos MORI's weighting approach was to generate **design weights**. These adjust for differences in selection probabilities between the various parts of the sample of businesses. They make the profile of the selected sample look like the population of businesses that this study is interested in, by the three population groups identified in section 2.2. The aim here is to remove the biases we introduced as part of the sample design. This was done using the group information marked in the sample provided by HMRC, since the intention of this is removing bias introduced when sampling, and this is the variable that was used to sample on.

The next phase was to **weight to correct for variable response rate**. The analysis showed that the response rates varied across each of the population categories. Overall hit rates were higher for sole traders / partnerships than for companies, as can be seen in Table A.2 overleaf. Businesses that were part of the Annual Accounting Scheme were over-sampled as they were of specific policy interest. Whilst the selection weights ensured these businesses were not over-represented in the issued sample, these businesses were treated separately when making the non-response adjustment to ensure the proportion of businesses in the final, weighted sample remained the same as that in the population.

**Table A.2 – Population profile compared with the selected sample and achieved sample profiles**

Group (from the sample)	Label	Population	Unweighted selected sample	Weighted selected sample	Achieved sample (selection weight only)
1 – voluntary registered	Incorporated company (not Annual Accounting Scheme)	84%	79%	84%	71%
	Sole Trader or Partnership (not Annual Accounting)	16%	15%	16%	27%
	Annual Accounting Scheme	1%	6%	1%	1%
	Total	100%	100%	100%	100%
2 – mandatory registered	Incorporated company (not Annual Accounting)	84%	80%	84%	72%
	Sole Trader or Partnership (not Annual Accounting)	16%	16%	16%	27%
	Annual Accounting Scheme	1%	4%	1%	2%
	Total	100%	100%	100%	100%
3 – unregistered borderline	Incorporated company	26%	37%	26%	18%
	Sole trader	66%	56%	66%	77%
	Partnership	8%	7%	8%	6%
	Total	100%	100%	100%	100%

Table A.3 shows how the breakdown looks once the *final* group information is used (i.e. the group allocation based on answers given in the survey rather than the sample information). It shows how the profile changes a little due to movement between groups, but the higher response rates for sole traders is still evident.

**Table A.3 – Breakdown of sample used and response rate**

Group (from the sample)	Label	Achieved sample (selection weight only)
1 – voluntary registered	Incorporated company (not Annual Accounting)	75%
	Sole Trader or Partnership (not Annual Accounting)	23%
	Annual Accounting Scheme	1%
	Total	100%
2 – mandatory registered	Incorporated company (not Annual Accounting)	62%
	Sole Trader or Partnership (not Annual Accounting)	37%
	Annual Accounting Scheme	2%
	Total	100%
3 – unregistered borderline	Incorporated company	18%
	Sole trader	76%
	Partnership	6%
	Total	100%

The company / partnership split is an important sample characteristic, so we made the decision to make a further adjustment for businesses in the final Groups 1 and 2 population<sup>21</sup> (this includes businesses from Group 3 who were re-allocated to Group 1 or 2 based on their questionnaire responses). The combined Groups 1 and 2 sample has been weighted so that the company/partnership profile matches that of the combined Groups 1 and 2 population. No further adjustments were made to the remaining Group 3 businesses due to some uncertainty around the population estimates.

The population estimates for Groups 1 and 2 were believed to include 'movers'<sup>22</sup> from Group 3 that could not be identified through a de-duplication process at the sampling stage. This was reinforced by the fact that the bulk of the movers are sole traders / partnerships – the very groups that were harder to match. This suggests the Groups 1 and 2 population estimates are appropriate to use for Groups 1 and 2 and the reallocated Group 3 cases. These combined cases were therefore weighted to the combined Groups 1 and 2 population estimates.

<sup>21</sup> Numbering of groups is as per Table A.2 and A.3.

<sup>22</sup> Those who had initially been identified in the sample as being in Group 3 but through responses to the questionnaire were reallocated to either Group 1 or Group 2.

## Appendix 3: Achieved sample

**Table A.4 – Unweighted and weighted profile of interviews achieved in the survey**

Group	Stratification variable	Unweighted	Weighted
Voluntarily registered – below VAT threshold at time of registration in 2013/14 and 2014/15	Incorporated company	79%	84%
	Sole Trader or Partnership	15%	16%
	Annual Accounting scheme	6%	1%
	Total	100%	100%
Mandatory registered – exceeded VAT threshold at time of registration in 2013/14 and 2014/15	Incorporated company	80%	84%
	Sole Trader or Partnership	16%	16%
	Annual Accounting scheme	4%	1%
	Total	100%	100%
Unregistered borderline – turnover up to £7,000 below threshold in 2012/13 and 2013/14	Incorporated company	37%	18%
	Sole trader	56%	76%
	Partnership	7%	6%
	Total	100%	100%

**Table A.5 – Breakdown of depth interviews**

Group	Primary variable	Secondary variable
Voluntarily registered (14) Mandatory registered (14)	Cash Accounting scheme user (5) Annual Accounting scheme user (5) Flat Rate scheme user (5) Never used scheme - heard of at least one (4) Never heard of scheme (4)	Use agent for VAT administration (10) Do not use agent for VAT administration (10)
Unregistered borderline businesses (12)	Confirmed illegal restricting activity (4) Confirmed complex restricting activity (4) <sup>23</sup> Confirmed legal restricting activity (4)	

<sup>23</sup> 'Complex restricting activity' refers to activities identified as part of the survey, which may be illegal depending on the details of the case. Examples include asking customers to buy materials or where two businesses are set up (separate legal entities, but linked in terms of the service/good they are providing).

## Appendix 4: Additional tables and information

**Table A.6 – Trading status**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Still owned by respondent and trading	96%	96%	100%
Been sold or passed on	*%	*%	0%
Ceased trading, closed or liquidated	4%	4%	0%

**Table A.7 – Sector of activity**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Professional, Scientific and Technical Activities	37%	23%	13%
Information and Communications	14%	11%	1%
Wholesale and Retail Trade	10%	14%	16%
Construction	9%	13%	8%
Transport and storage	6%	1%	3%
Accommodation and Food Service Sector	5%	13%	17%
Manufacturing	4%	5%	2%
Real Estate Activities	3%	2%	2%
Administrative and Support Service Activities	3%	4%	6%
Other Service Activities	3%	4%	18%
Agriculture, Forestry and Fishing	1%	1%	4%
Electricity, Gas, Steam and Air Conditioning Supply	1%	*%	2%
Financial and Insurance Activities (excluding holding companies)	1%	1%	1%
Education	1%	3%	1%
Human Health and Social Work Activities	1%	1%	2%
Arts, Entertainment and Recreation	1%	2%	4%
Water Supply, Sewerage and Waste Management	*%	0%	*%
Mining and Quarrying	0%	*%	*%
Public Administration and Defence	0%	*%	0%
Activities of Households as Employers	0%	*%	0%
Other	0%	*%	*%
Don't know	0%	0%	*%

**Table A.8 – Number of directors**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All companies</i>	564	397	164
One	66%	50%	58%
Two	30%	44%	32%
Three or More	4%	6%	9%

**Table A.9 – Turnover in last financial year**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Up to £20,000	21%	9%	8%
More than £20,000 up to £40,000	9%	1%	4%
More than £40,000 up to £60,000	14%	1%	12%
More than £60,000 up to £80,000	13%	12%	59%
More than £80,000 up to £100,000	11%	23%	4%
More than £100,000 up to £120,000	4%	12%	*%
More than £120,000 up to £140,000	4%	7%	*%
More than £140,000 up to £160,000	3%	6%	*%
More than £160,000	10%	23%	2%
Don't know	10%	5%	9%
Refused	1%	2%	2%

**Table A.10 – Length of trading**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Up to three years	58%	41%	7%
More than three years up to five years	25%	27%	15%
More than five years up to ten years	10%	16%	31%
More than ten years	4%	12%	48%
Don't know	2%	3%	*%
Refused	0%	*%	0%

**Table A.11 – Methods of accounting for sales**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Invoice	89%	79%	54%
Transaction at the time of purchase	15%	30%	52%
Pre-funded account	2%	2%	2%
Don't know	1%	1%	2%
Refused	*%	*%	*%

**Table A.12 – Main method of accounting for sales**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Invoice	86%	74%	49%
Transaction at the time of purchase	11%	24%	46%
Pre-funded account	1%	*%	1%
Don't know	2%	1%	2%
Refused	1%	1%	2%

**Table A.13 – Payment options available to customers**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Bank transfer	91%	84%	63%
Cheque	54%	59%	65%
Cash	31%	45%	70%
Debit card	22%	37%	37%
Credit card	21%	36%	36%
Standing order	20%	22%	15%
Don't know	*%	*%	1%
Refused	*%	*%	*%

**Table A.14 – Main payment option**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Bank transfer	81%	64%	36%
Cheque	3%	4%	12%
Cash	4%	8%	20%
Debit card	4%	12%	14%
Credit card	3%	5%	8%
Standing order	1%	1%	2%
Don't know	2%	4%	8%
Refused	1%	1%	2%

**Table A.15 – Preferred method of receiving payment**

	Voluntary registered	Mandatory registered	Unregistered borderline
<i>All businesses</i>	761	644	604
Bank transfer	83%	71%	46%
Debit card	7%	14%	16%
Cash	4%	7%	18%
Credit card	3%	5%	6%
Cheque	2%	2%	8%
Standing order	2%	1%	3%
Don't know	2%	4%	7%
Refused	*%	*%	1%

**Table A.16 – Change in size of business and turnover since registering for VAT**

	Voluntary registered		Mandatory registered	
	At time registered for VAT	Now/Last financial year (2014/15)	At time registered for VAT	Now/Last financial year (2014/15)
<i>Base: All who did not register in the last financial year</i>	401	401	352	352
<i>Number of employees:</i>				
Nano business (zero employees)	54%	49%	32%	27%
Micro business (1-4 employees)	43%	43%	59%	60%
Small business (5-9 employees)	2%	6%	5%	10%
Small business (10-49 employees)	1%	2%	4%	4%
Medium business (50-249 employees)	*	1%	0%	0%
Don't know	0%	0%	*%	0%
Refused	0%	0%	0%	0%
<i>Turnover:</i>				
Up to £20,000	18%	25%	9%	14%
More than £20,000 up to £40,000	14%	9%	2%	1%
More than £40,000 up to £60,000	15%	14%	3%	2%
More than £60,000 up to £80,000	23%	11%	17%	10%
More than £80,000 up to £100,000	12%	13%	25%	20%
More than £100,000	14%	29%	41%	54%
Don't know	3%	0%	2%	0%
Refused	1%	0%	1%	0%

**Table A.17 – Difficulties faced by businesses in early years**

	VAT registered	Unregistered borderline
<i>Base: All VAT registered businesses less than five years old when they registered/unregistered borderline businesses less than five years old</i>	1,156	84
<b>General business issues</b>	<b>23%</b>	<b>35%</b>
General business issues e.g. competition, economic conditions	13%	19%
Establishing business/building a brand	8%	16%
Finding /keeping the right staff/skilled staff	6%	1%
Personal issues - e.g. long hours/pressure/tiredness	3%	6%
<b>Cash flow problems</b>	<b>20%</b>	<b>21%</b>
Cash flow problems caused by late or non-payment	9%	3%
Cash flow problems caused by unexpected tax bills	5%	1%
Cash flow problems caused by fewer sales than anticipated	3%	2%
Cash flow problems – other issues	8%	16%
<b>Administration/compliance</b>	<b>19%</b>	<b>5%</b>
Bureaucracy/regulation/compliance/red tape	10%	1%
General tax compliance e.g. record keeping, tax returns	8%	3%
Paying taxes/filing returns correctly/on time	4%	0%
High taxes/tax liabilities	3%	1%
<b>Finance/pricing/customers</b>	<b>17%</b>	<b>27%</b>
Finding and keeping customers/clients	9%	18%
Financial management	5%	6%
Barriers to borrowing/access to finance/poor terms	4%	9%
<b>No difficulties</b>	<b>39%</b>	<b>35%</b>
Don't know	1%	2%

**Table A.18 – Awareness of the current VAT threshold**

	Unregistered borderline
<i>Base: All unregistered borderline businesses who are aware of registering for VAT above a certain threshold</i>	579
Above £82,000	14%
<b>£82,000</b>	<b>28%</b>
£81,000	10%
£80,000	8%
£79,000	3%
Below £79,000	18%
Other	4%
Don't know	16%

**Table A.19 – Main benefits of VAT registration**

	All VAT registered	Voluntary registered	Mandatory registered
<i>All businesses*</i>	1,405	761	644
<b>Financial benefits</b>	<b>47%</b>	<b>51%</b>	<b>39%</b>
Claiming back VAT from other registered businesses	31%	33%	27%
Financial/tax benefit	14%	16%	12%
Made profit on VAT charged	5%	6%	3%
Mainly sell to other VAT registered businesses	3%	3%	2%
<b>Helps business growth/image</b>	<b>21%</b>	<b>25%</b>	<b>15%</b>
Improved reputation/credibility/image	18%	20%	12%
More appealing to customers/suppliers	5%	6%	3%
Helps business grow	3%	3%	3%
Assumed it was obligatory from the start/turnover exceeded the threshold	7%	6%	8%
Other	1%	2%	*9%
<b>None/no benefits</b>	<b>29%</b>	<b>24%</b>	<b>39%</b>
Don't know	5%	5%	3%

\* Mentions 2% or less not shown

**Table A.20 – Anticipated and actual drawbacks of registration**

	Anticipated			Actual		
	All	Voluntary	Mandatory	All	Voluntary	Mandatory
<i>Base: All businesses*</i>	1,405	761	644	1,405	761	644
<b>Financial loss/ prices/increase VAT bills</b>	<b>23%</b>	<b>18%</b>	<b>31%</b>	<b>31%</b>	<b>24%</b>	<b>43%</b>
Prices of the goods and services sold would increase/ put off customers	11%	9%	15%	12%	9%	16%
Concern over having large VAT bill	7%	5%	10%	8%	7%	10%
Profits would be reduced	6%	4%	10%	9%	7%	14%
<b>Administrative burden</b>	<b>34%</b>	<b>35%</b>	<b>31%</b>	<b>47%</b>	<b>50%</b>	<b>42%</b>
Extra paperwork and administration	27%	28%	25%	38%	42%	31%
Maintaining accurate/up-to-date VAT accounting records	7%	7%	6%	7%	7%	9%
Additional costs to undertaking extra paperwork and administration	6%	5%	9%	9%	7%	11%
Filing VAT returns	5%	5%	7%	8%	8%	9%
Keeping all VAT invoices and receipts	4%	4%	5%	5%	4%	7%
It was a new company/ VAT registered from the start	2%	2%	3%	0%	0%	0%
<b>None/no drawbacks</b>	<b>41%</b>	<b>43%</b>	<b>38%</b>	<b>28%</b>	<b>29%</b>	<b>27%</b>

\* Mentions 2% or less not shown

**Table A.21 – Reasons for requesting a different VAT stagger**

	All VAT registered
<i>All VAT registered businesses that requested a different stagger period</i>	160
Alignment with payment of other taxes	46%
Reduced administrative burden or complexities	14%
Helps cash flow generally	12%
Personal reasons specific to period when quarterly cycle was requested	4%
Spreads out payment of VAT with other taxes	4%
Was advised to do so	4%
Compulsory on the VAT scheme used	2%
It better reflected the timings of contracts/payments from customers	2%
Reduced costs associated with administration	2%
It better reflected seasonal work	1%
Other	7%
Don't know	12%

**Table A.22 – Benefits of VAT alignment with other tax obligations**

	All VAT registered
<i>All VAT registered businesses who have taxes aligned</i>	884
Less worry/gets it all done at the same time	32%
Reduced administrative burden or complexities	27%
Easier to plan or make long term business decisions	14%
Aligns more conveniently with contracts/ seasonal work	4%
Helps cash flow generally	4%
Reduced costs associated with administration	4%
More time to concentrate on other things	3%
Helps to keep an eye on costs/ figures/ plan budgets	1%
Accountant set it up this way	1%
Makes sense to do so / more logical	1%
More cash invested in business	*%
None – no particular benefits	18%
Other	2%
Don't know/refused	13%

Table A.23 – Sources of information on the schemes

	VAT registered			Unregistered borderline		
	Flat Rate	Annual Accounting	Cash Accounting	Flat Rate	Annual Accounting	Cash Accounting
<b>All who have at least heard of each scheme</b>	1,021	580	607	257	189	172
<b>Professional advice</b>	57%	38%	43%	44%	48%	38%
<b>HMRC</b>	22%	36%	30%	24%	23%	30%
<b>Business/work/colleagues</b>	10%	6%	6%	11%	7%	6%
<b>Family/friends</b>	4%	1%	2%	7%	5%	3%
<b>Did not approach anyone for advice</b>	12%	20%	22%	17%	22%	23%
<b>Don't know</b>	3%	4%	3%	5%	4%	8%

**Table A.24 – Expectations and experiences of Flat Rate scheme**

	<b>Expectations</b>	<b>Experiences</b>
<i>Base: All VAT registered who have used the scheme</i>	575	575
<b>Financial tax benefit</b>	<b>42%</b>	<b>41%</b>
Provides a financial benefit to the business	32%	34%
Tax benefit to using the scheme/pay less tax	12%	10%
Reduced need for accountant – saved money that way	4%	2%
<b>Saves time/eases admin burden</b>	<b>50%</b>	<b>60%</b>
Saves me/my business time	20%	24%
Save staff time dealing with VAT administration	13%	14%
Makes it easier to meet tax obligations	12%	14%
Reduces the administrative burden on the business	16%	21%
Easier to meet VAT obligations/ensures I am compliant	14%	15%
Has improved record keeping in the business	4%	3%
It's simple / easy to use	6%	6%
<b>Helped business generally</b>	<b>9%</b>	<b>2%</b>
Helps business generally – e.g. to grow/incorporate	6%	2%
Suits the type of company	3%	N/A
Better image/ credibility	1%	N/A
<b>Put in place by someone else</b>	<b>18%</b>	<b>N/A</b>
Put in place by an agent or accountant	9%	N/A
Put in place by HMRC	*%	N/A
Believed had no choice to use the scheme	*%	N/A
Agent recommended business to use the scheme	10%	N/A
Better image/ credibility	1%	N/A
Other	2%	2%
<b>None/there are no benefits</b>	<b>N/A</b>	<b>7%</b>
Don't know	2%	7%

**Table A.25 – Expectations and experiences of Cash Accounting scheme**

	Expectations	Experiences
<i>Base: All VAT registered who have used the scheme</i>	182	182
<b>Financial tax benefit</b>	<b>45%</b>	<b>58%</b>
Provides a financial benefit to the business	42%	51%
Tax benefit to using the scheme/pay less tax	3%	6%
Reduced need for accountant – saved money that way	*%	3%
<b>Saves time/eases admin burden</b>	<b>31%</b>	<b>34%</b>
Saves me/my business time	12%	8%
Save staff time dealing with VAT administration	4%	4%
Makes it easier to meet tax obligations	4%	8%
Reduces the administrative burden on the business	4%	5%
Easier to meet VAT obligations/ensures I am compliant	8%	11%
Has improved record keeping in the business	5%	5%
It's simple / easy to use	6%	8%
<b>Helped business generally</b>	<b>12%</b>	<b>3%</b>
Helps business generally – e.g. to grow/incorporate	7%	3%
Suits the type of company	4%	N/A
<b>Put in place by someone else</b>	<b>13%</b>	<b>N/A</b>
Put in place by an agent or accountant	8%	N/A
Put in place by HMRC	*%	N/A
Believed had no choice to use the scheme	1%	N/A
Agent recommended business to use the scheme	3%	N/A
Other	6%	3%
<b>None/there are no benefits</b>	<b>N/A</b>	<b>8%</b>
Don't know	3%	3%

**Table A.26 – Expectations and experiences of Annual Accounting scheme**

	Expectations	Experiences
<i>Base: All VAT registered who have used the scheme</i>	134	134
<b>Financial tax benefit</b>	<b>20%</b>	<b>14%</b>
Provides a financial benefit to the business	18%	13%
Tax benefit to using the scheme/pay less tax	3%	*%
Reduced need for accountant – saved money that way	1%	1%
<b>Saves time/eases admin burden</b>	<b>36%</b>	<b>50%</b>
Saves me/my business time	7%	15%
Save staff time dealing with VAT administration	8%	7%
Makes it easier to meet tax obligations	3%	6%
Reduces the administrative burden on the business	13%	12%
Easier to meet VAT obligations/ensures I am compliant	5%	19%
Has improved record keeping in the business	2%	9%
It's simple / easy to use	6%	1%
<b>Helped business generally</b>	<b>8%</b>	<b>1%</b>
Helps business generally – e.g. to grow/incorporate	3%	1%
Suits the type of company	5%	N/A
<b>Put in place by someone else</b>	<b>21%</b>	<b>N/A</b>
Put in place by an agent or accountant	5%	N/A
Put in place by HMRC	5%	N/A
Believed had no choice to use the scheme	1%	N/A
Agent recommended business to use the scheme	13%	N/A
Other	4%	3%
<b>None/there are no benefits</b>	<b>N/A</b>	<b>16%</b>
Don't know	14%	23%

**Table A.27 – Main reasons for not using the schemes**

	All VAT registered	Voluntary registered	Mandatory registered
<i>All businesses who did not use schemes</i>	587	310	277
<b>Lack of awareness/knowledge</b>	<b>33%</b>	<b>34%</b>	<b>31%</b>
Lack of awareness of schemes/did not know about it	31%	33%	27%
Not clear on what the choices are/that there is a choice	4%	4%	4%
Don't understand tax information generally/don't know enough about it	3%	2%	3%
<b>Accountant/agent reasons</b>	<b>20%</b>	<b>18%</b>	<b>22%</b>
Accountant/agent/tax advisor advised not to use it	19%	18%	21%
Do not have accountant/agent/tax advisor to advise/cannot afford fees	*%	0%	1%
<b>HMRC information/trust</b>	<b>2%</b>	<b>2%</b>	<b>2%</b>
HMRC information/guidance/ website not tailored/personalised to business	1%	1%	2%
HMRC information/guidance/ website not clear	1%	1%	0%
Do not trust HMRC	*%	1%	0%
<b>Control/administration</b>	<b>2%</b>	<b>1%</b>	<b>2%</b>
Not sufficient reduction in administrative burden on the business	1%	1%	2%
Reasons related to control/Want to retain control of business (e.g. didn't want to make decision without information etc.)	*%	1%	*
Would have to change record keeping	*%	0%	*
<b>No particular reason(s)/Not relevant to business</b>	<b>27%</b>	<b>27%</b>	<b>28%</b>
<b>Not sufficient cash savings to the business</b>	<b>2%</b>	<b>2%</b>	<b>2%</b>
Don't know	3%	3%	2%
Refused	1%	0%	1%



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