



TAXING TIMES

ROUTES TO REFORM FOR SMALL BUSINESSES AS TAXPAYERS

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Experts in Business

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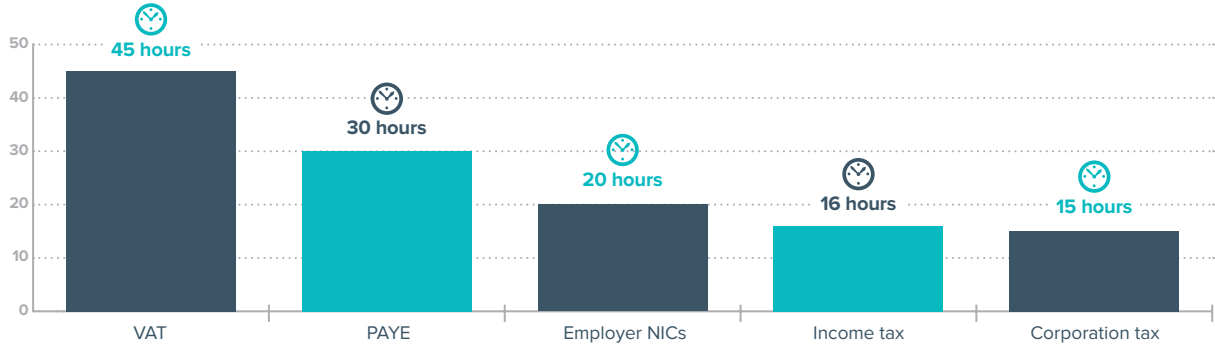
ABOUT FSB

The Federation of Small Businesses (FSB) is the UK's leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that's led by our members, for our members. Our mission is to help smaller businesses achieve their ambitions. As experts in business, we offer our members a wide range of vital business services, including advice, financial expertise, support and a powerful voice in Government. FSB is also the UK's leading business campaigner, focused on delivering change which supports smaller businesses to grow and succeed. Our lobbying arm starts with the work of our team in Westminster, which focuses on UK and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

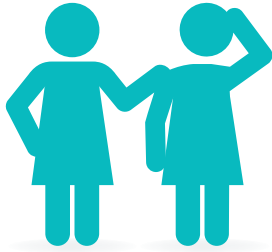
TAXING TIMES

ROUTES TO REFORM FOR SMALL BUSINESSES AS TAXPAYERS

Average small business loses three working weeks a year to tax compliance



77%



Of small firms **rely on specialists** to get their **taxes right**

£5,000



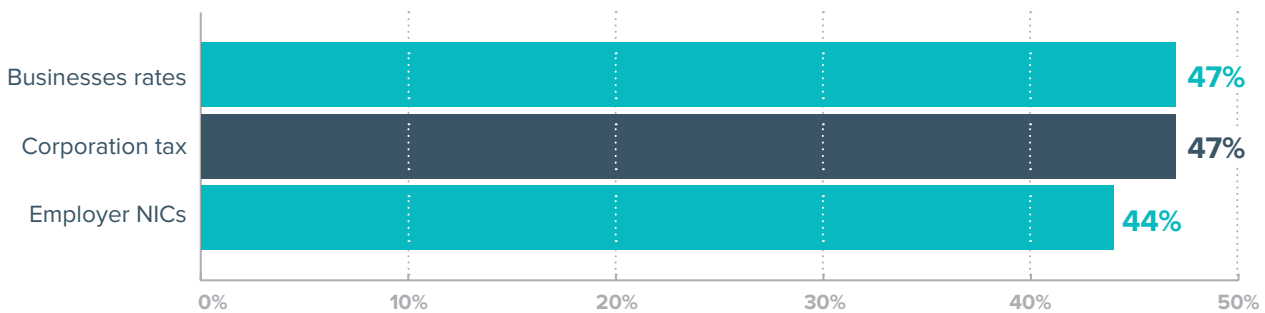
Average small business **spend on tax compliance** every year

55%



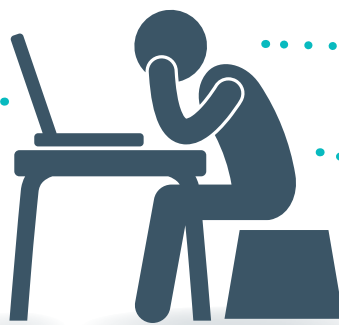
Of small businesses **don't feel informed** about available **tax reliefs**

Taxes most likely to stifle small business growth



46%

Of small firms say it's **hard to determine** the **tax rate** they're required to pay



40%

Find **exemptions confusing**

38%

Have **difficulty understanding** thresholds

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FOREWORD

Simplifying the tax system is a critical public policy objective. And it is even more important given the challenges and opportunities of Brexit that first order issues such as tax simplification, and in particular reducing cumulative compliance costs for small businesses and the self-employed, are not kicked into the long grass. Small businesses are the engine of the UK economy. They need and deserve a tax system that supports their growth and productivity ambitions.

The UK tax system is undeniably complicated. Many small businesses and self-employed entrepreneurs have limited time and resources, which poses a particular challenge when dealing with complex calculation and reporting processes.

Tax simplification has traditionally been seen as an issue of legislation, with much of the public debate focusing on the length and complexity of the UK's tax code. However, we want to shine a light on the compliance challenges and costs related to complex tax calculation and payment processes. The 'user experience' of the current tax system is an area that the Government must seek to improve. This FSB research shows that small businesses lose, on average, around £5,000 every year to tax compliance costs. FSB research suggests that around three quarters (77%) choose to pay a specialist – either in-house or an external service – to get their taxes right.

A major component of compliance costs is understanding which tax related obligations apply and what needs to be done to comply with them. According to our research, small businesses say that most taxes are, on balance, difficult to understand. Many consider VAT to be the most conceptually straightforward of all the taxes they pay. However, it is also considered the most time-consuming tax with which to comply. So, in addition to simplifying processes, Government must provide effective communication, guidance and tools.

Making Tax Digital (MTD) presents an opportunity to simplify and speed up tax compliance. However, in order to maximise its benefits, the design of MTD must be sharply focused on the user experience. There is a risk that new technologies could result in more arduous and expensive processes for small firms, particularly if systems are poorly designed or businesses are underprepared. That is why FSB has successfully lobbied government to ensure MTD remains voluntary for businesses and the solo self-employed below the VAT threshold for the foreseeable future. These businesses must have the flexibility and choice to adopt MTD when it is right for them.

Government uses the tax system to influence behaviour. Tax reliefs encourage actions that have a positive impact on the broader economy, such as job creation and investment in innovation. However, our research shows that, in many cases, small businesses remain unaware of these reliefs. Government and the business support community must drive higher awareness of tax reliefs. Most worryingly, our research shows that there is little evidence that small businesses are proactively helped to explore potential future tax reliefs when planning their forthcoming activities and investments.

The introduction of MTD should provide greater insight into business activities and improve government's ability to target relevant information and advice about tax reliefs to the right firms at the right time in their lifecycle. However this is a long-term vision. Much more needs to be done in the here and now to improve the depth of tax relief knowledge among small businesses and their intermediaries.

This report makes the case for a more user-friendly tax system for small businesses which supports their wider growth aspirations. An empowered and unhindered small business community is critical to the success of the Industrial Strategy and the prosperity of the UK economy post-Brexit.



Martin McTague
FSB Policy Director

EXECUTIVE SUMMARY

The UK's tax system is complicated, difficult to understand and hard to navigate.¹ This complexity causes inefficiencies for many small business owners. Complicated tax rules create a substantial opportunity cost for small businesses – absorbing time they could otherwise spend innovating or delivering improved goods and services. FSB research shows some taxes have made it harder for some businesses to expand and, in some cases, stopped growth completely.

Tax complexity arises from four different sources:

1. A complex tax code – enshrined in legislation
2. Communication of tax obligations
3. Processes associated with compliance
4. Cumulative burden of tax compliance

The UK currently has one of the longest tax codes in the world.² Previous attempts to simplify the UK's tax system have focused on the complexity of tax legislation.³ However, this report focuses on how the current system works for small businesses – the user experience. It addresses issues around communication, processes and cumulative burden (points 2-4 above). The evidence presented in this report shows that simplifying the existing tax system, particularly the processes attached to compliance, could help improve business growth and productivity.

The administrative costs of tax compliance include the costs of collecting data, keeping records, filing returns, making payments, liaising with the relevant tax authority, calculating liabilities and understanding exemptions.

Improvements suggested in this report will also reduce the volume of mistakes that businesses make in their tax administration. Compliance errors are, of course, costly for government, requiring additional resources to be expended on HMRC staff and systems.⁴

This report explores how businesses pay taxes and what assistance they need. It draws on survey data that highlights the methods used by small business taxpayers and how these shape their behaviour. It shows which individuals, within small businesses, conduct the bulk of the tasks relevant to tax compliance, how they record transactions and how they calculate their tax liability.

Easing the burden

Small businesses say that most taxes are, on balance, difficult to understand. Most (77%) rely on a specialist (e.g. an accountant) for assistance with elements of their tax calculations.

The roll out of the Making Tax Digital (MTD) initiative provides an opportunity to make improvements to the small business user experience. However, for those that are above the VAT threshold and therefore mandated to use MTD, it also creates a risk that administrative burdens and costs will be increased by the requirement to use technology, particularly if it is poorly designed. In order to realise the opportunity of MTD, the Government must focus on the administrative burden for small businesses, both for those required to undertake quarterly digital tax reporting and those who are below the VAT threshold but voluntarily choose to join MTD.

In this context, it is worth noting that FSB research shows a small but significant proportion of small businesses still rely on non-digital means for accounting or tax compliance purposes. For example, almost half (46%) still record some transactions manually. Many smaller businesses are held back by a lack of confidence in their digital skills (12%) and prohibitive software costs (25%).

1 KPMG "Succeeding in uncharted waters, Assessing the competitiveness of the UK" 2017

2 Length of Tax Legislation as a Measure of Complexity OTS, April 2012

3 Length of Tax Legislation as a Measure of Complexity OTS, April 2012

4 HMRC, Increasing the effectiveness of tax collection: a stocktake of progress since 2010, <https://www.nao.org.uk/wp-content/uploads/2015/02/Increasing-the-effectiveness-of-tax-collection-a-stocktake-of-progress-since-2010.pdf>

Incentivising behaviour change

Although government revenue is the primary function of the tax system, this is not its only purpose. This report assesses the different incentives that are built into the tax system, either through credits or reliefs, which aim to shape business behaviour. The desired outcome of these incentives is that businesses do more of the things that drive increased output, efficiency, employment and productivity, while limiting negative externalities. This report assesses how successful the current relief system is at shaping behaviour in this positive way.

Some tax incentive policies – designed to change behaviours – are being held back by low levels of awareness amongst small businesses. Many small businesses are unaware of the additional benefits they could receive from taking certain actions, such as increasing investment or employment. Small businesses appear to lack the internal expertise to be well informed about the broad suite of tax reliefs.

Small businesses overwhelmingly rely on tax specialists (normally their accountants) for information about tax reliefs. These specialists provide a holistic service, which should include signposting to the reliefs that might be available. More broadly, government, business groups and actors in the wider business support landscape can also play a greater role in signposting some of the reliefs that are available to small businesses – doing so could improve take-up and incentivise behavioural change. There is a limit to which non-tax business support experts are able to provide advice on the full range of reliefs available. In future, there may be digital solutions that can provide more comprehensive support, but in the short to medium-term the Government should prioritise increasing and improving advice and information provided by all actors in the wider business support landscape.

Small businesses are a diverse audience. They require a degree of segmentation when it comes to understanding and addressing the challenges of tax compliance and awareness. For instance, there are some small business owners (23%) who say they feel fairly well-informed about the tax reliefs available to them. It is clear that, for some small businesses, certain tax reliefs are effective at driving activity, including employment and investment decisions. However, most small businesses (75%) say they do not feel well-informed about tax reliefs.

This raises the question of what characteristics reliefs need to have to affect behaviour. FSB data indicates that reliefs are more likely to drive a change in behaviour if they have a significant financial impact and are easy to access. The point at which businesses are informed about different reliefs also has an impact. Small businesses typically consider tax reliefs during their tax reporting period, when reviewing their expenditure retrospectively. However, if the purpose of tax reliefs is to drive behavioural change, the best time to inform businesses of their benefits is when they are planning future actions, particularly around growth and improving productivity, rather than when they are reviewing the previous year.

Government policy aims are not being realised. Low awareness and take-up of tax reliefs means only a minority of businesses are being encouraged to increase productivity and reduce negative externalities.

KEY FINDINGS

User experience

- Small businesses find complying with the UK tax system complicated, time-consuming and costly
 - On average, 36 per cent of small business owners find it difficult to understand the taxes they are liable to pay
 - Small business owners spend, on average, 17.8 hours each year on tax administration for each of the taxes they must comply with, and, on average, have to comply with six different taxes, meaning they will spend three working weeks a year on tax administration
 - Small businesses spend, on average, a total of around £5,000 complying with their taxes – around half of this is spent on external experts
- There is still a significant proportion of small business owners who do not record their transactions or calculate their taxes digitally
 - Eight per cent of small business owners do not keep digital records of transactions
 - Of those businesses that calculate their own tax, nine per cent do not use a digital means of tax calculation
- A third of small businesses (33%) say that the existence of a tax has stopped them from growing their business
- A further third (37%) say the existence of a tax has made growing their business harder to realise

Reliefs

- Awareness of reliefs is generally fairly low among small businesses. Fifty-five percent of small businesses believe they are not well-informed about the reliefs available to them. This in turn limits uptake
- Some reliefs are vital to small businesses. For example, 14 per cent of those receiving business rates relief said that it allowed them to remain in their premises
- Accountants play a critical role in advising small businesses about tax reliefs. Two-thirds (67%) of those receiving reliefs, found out about them through their accountant

RECOMMENDATIONS

User experience

- 1. Government should prioritise efforts to simplify the process of small business compliance with the existing tax system, rather than seeking complex legislative changes to the UK tax code.** FSB wants the Government to address directly the practical difficulties many businesses face when it comes to tax compliance. Think tanks, business groups and other researchers also need to assess the complexity of the UK's tax system in a way that reflects what really matters to businesses. The primary consideration should be the length of time required for a small business owner to complete a tax return accurately.
- 2. Government must ensure that the design and development of Making Tax Digital (MTD) focusses on the user experience of small businesses, addressing their current compliance difficulties while ensuring the system itself does not create additional complexity.** Government should prioritise addressing pinch points in the current taxation system and preventing new ones from occurring through thorough user testing with small businesses prior to roll-out of MTD. Government also needs to innovate to create solutions to small business tax compliance challenges. Specifically, the Office of Tax Simplification (OTS) should have a role in reviewing the system throughout the process of development and implementation to ensure businesses experience a significant reduction to administrative burdens as a result of MTD.
- 3. Government should continue to pursue a voluntary approach to uptake of Making Tax Digital for business below the VAT threshold.** The Government should learn lessons from the introduction of digital tax systems in Australia and Finland, ensuring a voluntary rather than mandatory approach to MTD and quarterly tax reporting. There is a significant gap between the current digital capabilities of many small businesses and the digital skills needed to use quarterly tax reporting systems. In addition, there could also be accessibility issues for many taxpayers in remote areas who do not have effective internet connections. Upskilling and supporting businesses to cope with the challenges of adopting new digital technologies needs to be the immediate priority. Depending on a firm's existing resources, stage in its business journey and age of its proprietor, culture change can be a slow process. Forcing businesses to adopt new methods they are not comfortable with is more often than not counter-productive.
- 4. Government should work with software providers to ensure that more affordable accounting software is available to small businesses.** Digital accounting software will be essential for the delivery of MTD. There are a small number of free accounting solutions, but knowledge of – and access to – them is still limited. Government needs to support the development of a deeper supplier base and ensure that small businesses are exposed to the full range of software providers.
- 5. Government should increase HMRC capacity to provide direct advice via its web-chat, telephone and email services.** Government's own advice and guidance services play a vital role in bridging the gap between those that have access to advisers and those that do not. However HMRC's services have been found to be lacking in quality by some.⁵ Many businesses report being unable to reach knowledgeable HMRC advisors after long waiting times. The customer support system needs to be boosted with greater investment, particularly in services that provide direct support, such as the HMRC call centre and online chat function.

⁵ HMRC monthly performance update: December 2017, 1 February 2018, <https://www.gov.uk/government/publications/hmrc-monthly-performance-report-december-2017/hmrc-monthly-performance-update-december-2017>

Reliefs

- 6. Government should promote greater awareness of the tax reliefs available to small businesses at relevant points in their lifecycle.** Business owners generally lack awareness of the tax reliefs that are available, or potentially available, to them. Government (particularly HMRC) should ensure that reliefs are flagged at the relevant touchpoints in a small business' lifecycle. Making Tax Digital (MTD) should harness data gathered from small businesses to identify and flag potential reliefs.
- 7. Government should give Growth Hubs in England (and their equivalents in Scotland, Wales and Northern Ireland) a central role in providing information about appropriate small business tax reliefs.** Growth hubs are accessed by thousands of businesses and they often provide information to businesses that are aiming to grow. Ensuring that Growth Hubs are well-informed about the range of tax reliefs available to small businesses will help to raise awareness.
- 8. Business groups, accountants and banks – alongside other informed intermediaries – should play a greater role in directing firms towards tax reliefs, at the right times in their lifecycles.** It is not only Government that has a role to play in encouraging increased take-up of reliefs. Business groups, accountants and bank relationship managers are often considered trusted agents by many small business owners and looked upon as good sources of advice. These actors should also seek to broaden their knowledge of available tax reliefs so that they can advise their customers or clients accordingly. Government and business groups should look at how this could be best achieved. Small businesses should receive advice about tax reliefs at the start of a new tax year and other touchpoints associated with forward planning. This will ensure that tax reliefs are integrated into strategic growth plans, including investment decisions.

USER EXPERIENCE

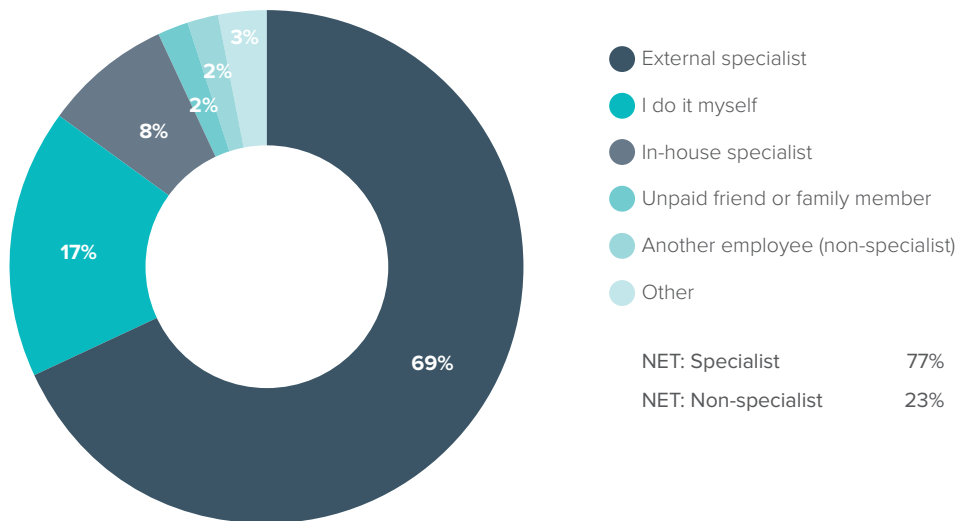
Small businesses vary in their approach to taxes. FSB surveyed 1071 small business owners across the UK to establish what methods they were using to meet their tax compliance requirements.

The data from this survey identifies some distinct groups – those that use specialists to help with their taxes and accounting and those that do not, along with those that use software and those that do not.

Who is responsible for tax administration in small businesses?

The majority (77%) of FSB small businesses and sole traders feel that calculating tax is complicated enough to require the services of a specialist, either in-house or external (Figure 1). Sixty-eight per cent say they either use the services of an external accountant or bookkeeper, while eight per cent of small businesses feel it necessary to have a professional employee to do their tax calculations. One in five small businesses (21%) say they are able to do their tax accounting without the help of a specialist. This is comprised of individuals that do their accounts themselves (17%), along with a small number that rely on a non-specialist employee or unpaid friends and family.

Figure 1: Sources used by small businesses for tax calculation
Source: FSB taxation survey (2017)



Three-quarters (77%) of small firms use a specialist to calculate their tax. This figure increases with size of business (74% for microbusinesses and sole traders, 91% for those with more than 10 employees). Larger businesses are more likely to have broader tax exposure and more complex tax-related affairs. They are also more likely to be able to afford specialist support.

FSB believes specialists play a vital role in helping small businesses navigate the complexities of the UK tax system. Those that are not able to access the services of a tax accountant are at an inherent disadvantage. However, individual businesses must make a judgement about the relative benefits of seeking specialist help, which can often be costly.

There is also a role for HMRC to provide small firms with the basic advice they need, free of charge. This can be done by boosting the capabilities of HMRC’s online and phone contact services. Currently, small businesses frequently flag the inconsistency of this service.

A landlord, interviewed during the research for this report, stated that they had to contact HMRC using the phone service on three occasions. Only on one of the occasions were they able to actually speak to someone at HMRC. This was after spending ten minutes on hold. On the other two occasions, only the automated service was reached. Both times, this service informed the customer that the call centre she was trying to reach was too busy to accept the call and she should try again later. The call was then ended.⁶

6 Summary of an interview with a landlord based in London.

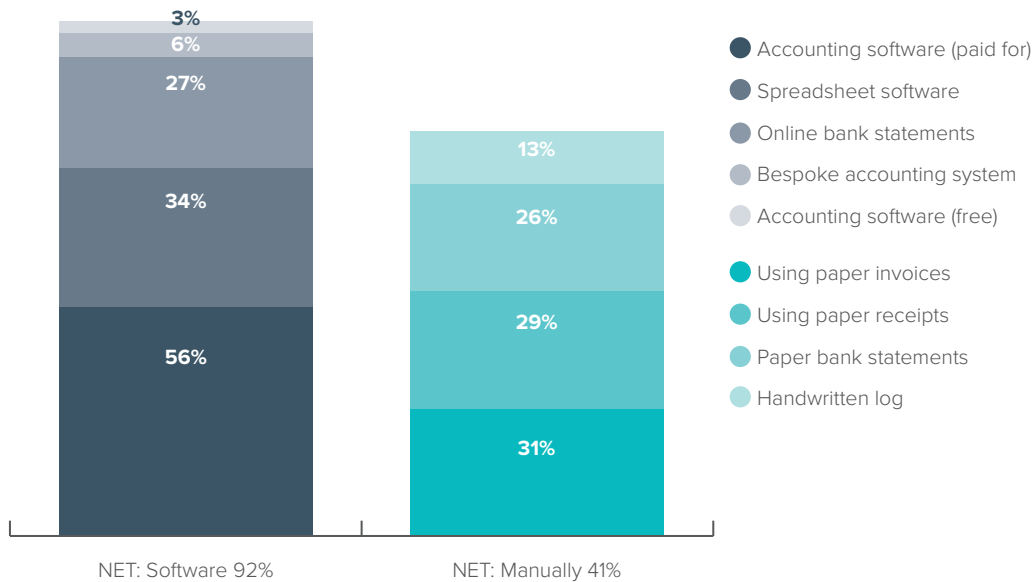
Recording transactions

Figure 2 shows that 92 per cent of FSB small businesses are using some sort of software to record their transactions.⁷ However, 41 per cent say they still use paper records to record some or all of their transactions.⁸

Over half (56%) of the small businesses surveyed use standard accounting software that they pay for. Another six per cent use bespoke accounting software, and three per cent use free accounting software. These businesses are perhaps closest to being able to adopt MTD requirements.

Even among businesses that do use some form of software there is a significant proportion that might not be well prepared to adopt MTD requirements. Just over a third (34%) use spreadsheet software, such as Microsoft Excel, and 27 per cent say they use online bank statements to help record their business transactions.

Figure 2: Small business methods for recording transactions
Source: FSB taxation survey (2017)



A meaningful proportion of small businesses continue to use non-digital means of recording transactions, such as paper invoices (31%), receipts (29%) and bank statements (26%), although most do so alongside digital means. Thirteen per cent still use a handwritten log.

There is a small but significant proportion of small businesses (8%) that only use paper records and no form of digital recording. These firms are the ones that will need the most help if they are to be encouraged to adopt MTD. This is particularly the case for those that still use a handwritten log. This group of businesses will exhibit a number of other indicators of low sophistication in their tax affairs. They generally employ fewer staff, are less likely to use a specialist and are less likely to be informed about and utilise tax reliefs. Perhaps most worryingly, they are more likely to have paid their taxes late.⁹ These business owners can be considered to be furthest from digital record keeping as no technology is used in their processes at all. This means their potential for error is greater and it makes the process of cross-referencing more difficult. For example, an online bank statement can provide a digital record of some transactions, which can be compared against previous logs. This may not be the case with a handwritten log.

⁷ Includes accounting software (paid for), spreadsheet software (e.g. excel), online bank statements, bespoke accounting system, accounting software (free)

⁸ Includes using paper invoices, using paper receipts, paper bank statements, handwritten log

⁹ FSB Tax Survey, October 2017.

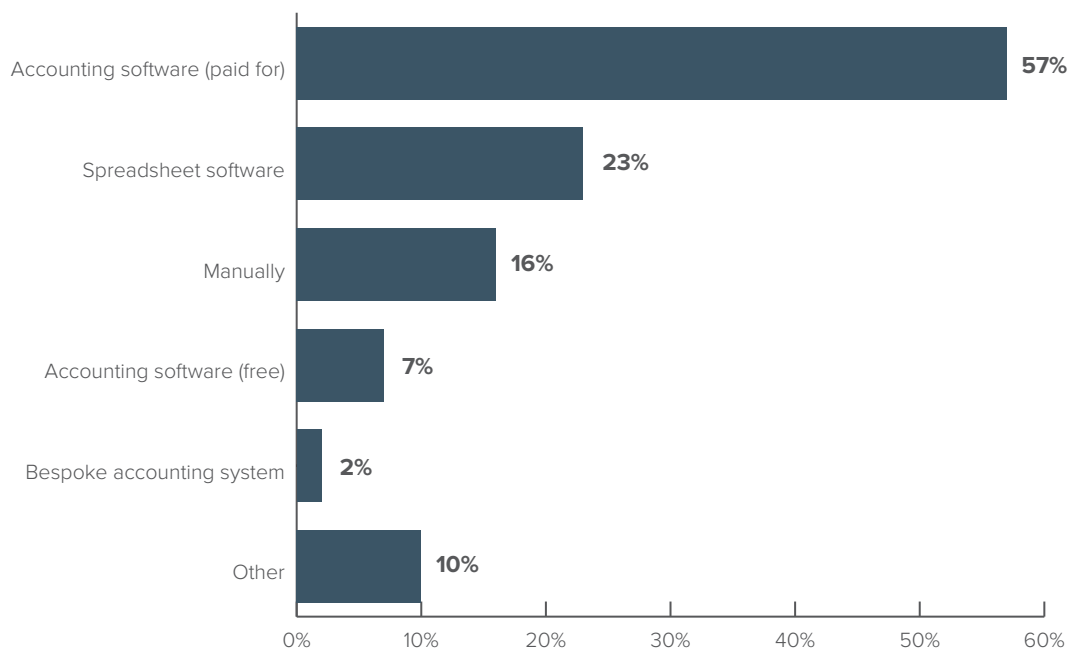
Overall, FSB data shows a large proportion of small business owners use some form of digital means to record their business transactions, but many supplement digital processes with some manual recording. MTD plans for VAT will allow businesses to update their digital records on a quarterly basis. This approach is welcome but the Government should also provide additional guidance on what is considered best practice and whether or not simply updating a system with manually entered data from receipts, invoices or bank statements will be acceptable.

Calculating tax

One in five small businesses (21%) say they are able to do their tax accounting without the help of a specialist. Of these, 83 per cent use accounting software to calculate all or some of their taxes (Figure 3).¹⁰

However, a small but significant proportion (16%) of businesses still use a manual means of calculating some or all of their tax liability, such as a calculator. And nine per cent say they do not use any digital means of tax calculation at all. These businesses tend to be smaller, employing fewer people and operating in lower tech industries, such as motor vehicle trade and repair, arts, and accommodation and food services.¹¹

Figure 3: Small business methods for calculating tax
Source: FSB taxation survey (2017)



Why are small firms not using digital tax platforms?

Most small businesses are now using digital means for at least part of their tax calculations, but there remains a significant minority that rely on manual methods.

Of those that do not use digital accounting software, over a third (38%) say the main reason for this is because they don't believe it is necessary. There is further work to do to persuade these business owners of the value of digital recording and reporting through software. Many will be wary of making changes to what they perceive to be a reliable and well-established system.

Affordability is another consideration, especially for those businesses with lower turnover. A quarter (25%) of those who do not use software for accounting or tax purposes believe it costs too much. There is limited awareness of free and cheap software options. Therefore, these options need to be better promoted. In order to ensure the success of the MTD project, the Government must

¹⁰ Includes accounting software (paid for), spreadsheet software (e.g. excel), accounting software (free), bespoke accounting system

¹¹ FSB Tax Survey, October 2017.

signpost free software services, ensuring quality products are available and these products are MTD-compliant. Many businesses feel fairly satisfied with how they are currently handling their accounts and, therefore, need further encouragement and education to incentivise a change in behaviour.

For some small businesses, a lack of digital skills is holding back use of software accounting solutions. More than one in 10 (12%) say they do not feel capable of using the software effectively. Recent FSB research also shows that a quarter of small business owners lack confidence in their basic digital skills.¹² A significant proportion of small business owners, therefore, are held back by their digital skills, or by their confidence in their digital capability. Many of these small businesses should be considered digitally excluded. Although HMRC has made provision for the digitally excluded, it is still unclear how broad this definition will be. It appears there is not a full awareness, in HMRC, of the degree to which digital skills are limited among a significant proportion of the business population. This will undoubtedly have implications for the roll out of MTD.

¹² Learning the Ropes, FSB, 2017, <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/skills-and-training-report.pdf?sfvrsn=0>

PAYING TAXES

Reasons for paying taxes late

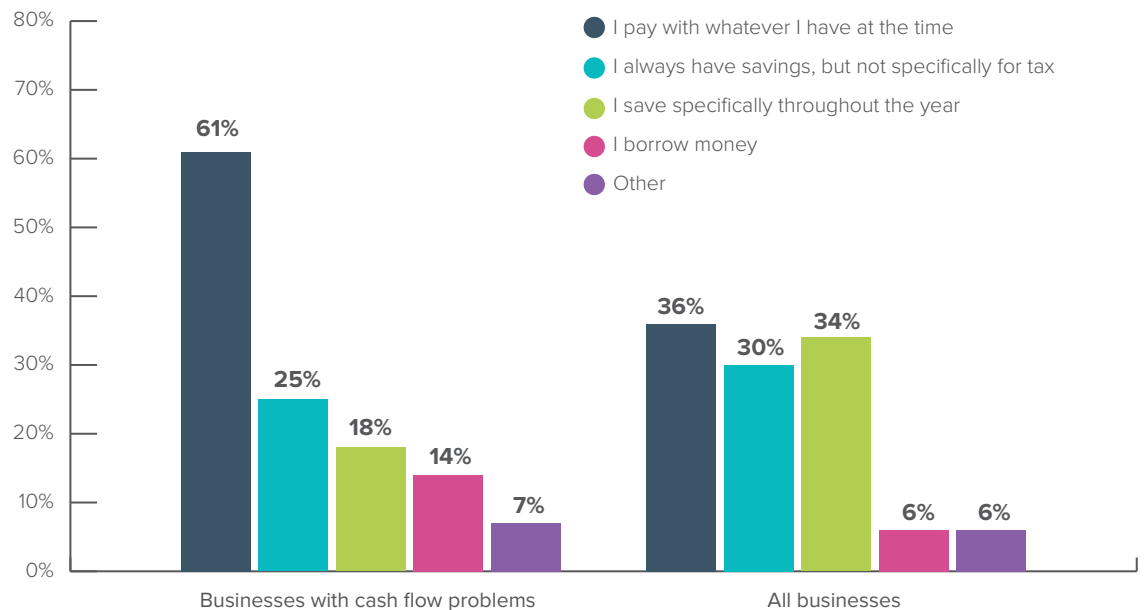
Most businesses (62.6%) have not paid their taxes late. Of those that have paid late, more than a third (36%) say this was caused by cash flow issues. Seventeen per cent say they missed payment as they were confused about deadlines.

Interestingly, there is not a strong relationship between those that use specialists or seek external advice and those that pay their taxes on time. Cash flow problems are the biggest self-identified issue causing small businesses to pay late, although a significant minority report being confused by deadlines. Because cash flow issues are the greatest problem for small businesses, exploring solutions that would make planning for tax expenses easier, such as having early tax estimates, should be considered a priority. Some of these potential solutions are examined later in this report.

Methods for meeting tax expenses

Many small businesses do not appear to be planning effectively for their tax expenses. Although nearly two-thirds say they have never paid a tax bill late, the largest proportion of respondents (37%) say they pay with whatever money they have at the time. Positively, a third (34%) put money aside specifically for their taxes, and 31 per cent say they have savings more generally, but do not save specifically for taxes. Worryingly, five per cent of respondents say they have borrowed money in order to meet their tax obligations.

Figure 4: Small business means to meeting tax expenses
Source: FSB taxation survey (2017)



Among those with cash flow problems, the proportion of those that are borrowing money in order to meet tax liabilities increases by three times compared to the general average.

Prior research from FSB shows that the solo self-employed are particularly poorly prepared for tax planning because they experience fluctuating incomes. Nearly half (44%) of the self-employed FSB members surveyed for the 2016 'Going It Alone'¹³ report said that they experienced a lack of certainty about their earnings. This presents a challenge for tax payment. Without being able to accurately estimate earnings, a business owner is unlikely to be able to foresee their tax liability and will face uncertainty around whether or not they will have the money to cover that liability at the time the tax is due.

Of those that save specifically for their tax expenses throughout the year, only a quarter (26%) say they have paid late. Of those that say they pay with whatever they have, nearly half (49%) have paid late.

¹³ FSB, Supporting self-employment in the UK, 2016.

SEEKING TAX ADVICE

The who and where of small business tax advice

The vast majority of small business owners have sought external tax advice at some point, with only six per cent saying they have never done so.

Most business owners go to an external specialist – an accountant or tax advisor – when they feel they need advice (Figure 5). Only a small minority appear to opt for non-specialist advisors. This is a marker of how complex the task of accounting is regarded to be. Small businesses tend to only trust an expert with their accounts, recognising the importance of getting their taxes right.

Accountants are often regarded as a business owner’s most trusted advisor.¹⁴ One of the main reasons is the alignment of interests between the two parties. Accountants, perhaps more than any other skilled person, rely on their clients’ repeated success in order to thrive themselves.

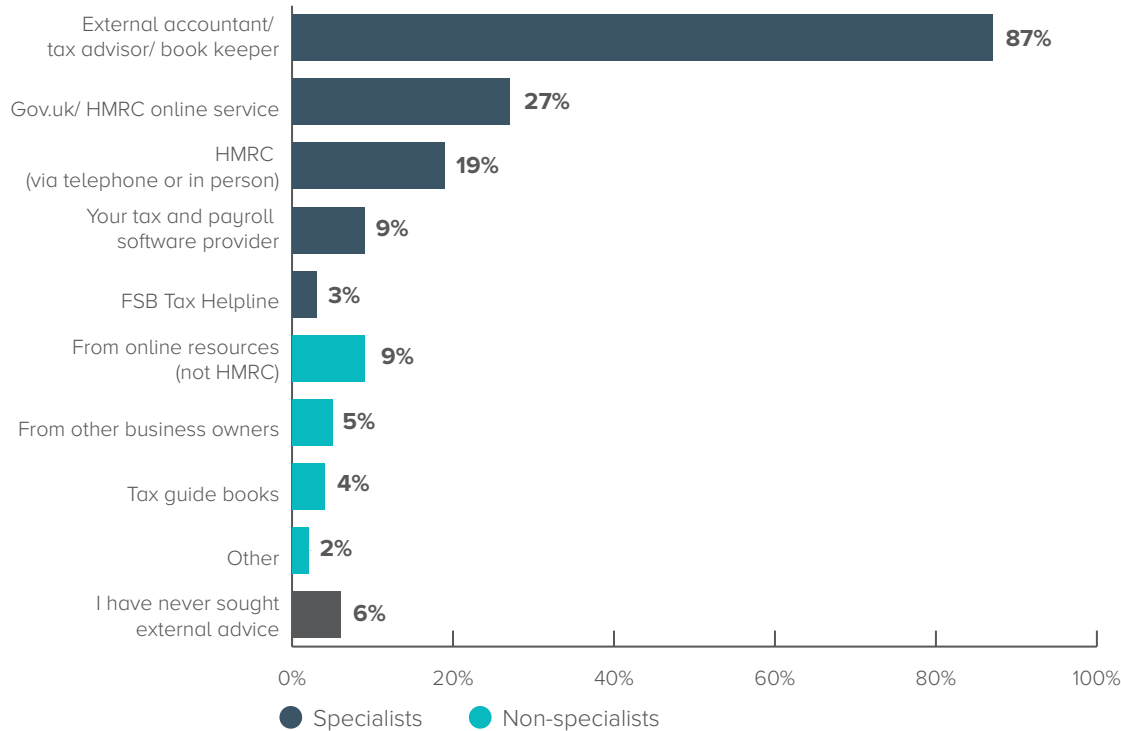
External accountants appear to be deemed most appropriate because, for small businesses, employing someone who solely looks after the businesses finances and not any of the core functions of the business is often not a viable or affordable option.

A markedly smaller proportion of business owners seek advice from HMRC, but their online and telephone services are the second and third most selected sources, respectively. HMRC’s online services appear to be a more attractive means of getting advice from HMRC than via telephone. Considerably more respondents said they went online for advice from HMRC (27%) than made a call (19%). This, in part, might be due to the poor service provided by HMRC’s telephone system. One interviewee mentioned their difficulty in reaching the HMRC’s telephone assistance:

“HMRC’s telephone service can take up to half an hour to speak to someone without an answer. HMRC are equally unresponsive when attempting to communicate with them via letters.”¹⁵

FSB Member, Accountancy Firm, Thames Valley

Figure 5: Small business sources for tax advice
Source: FSB taxation survey (2017)



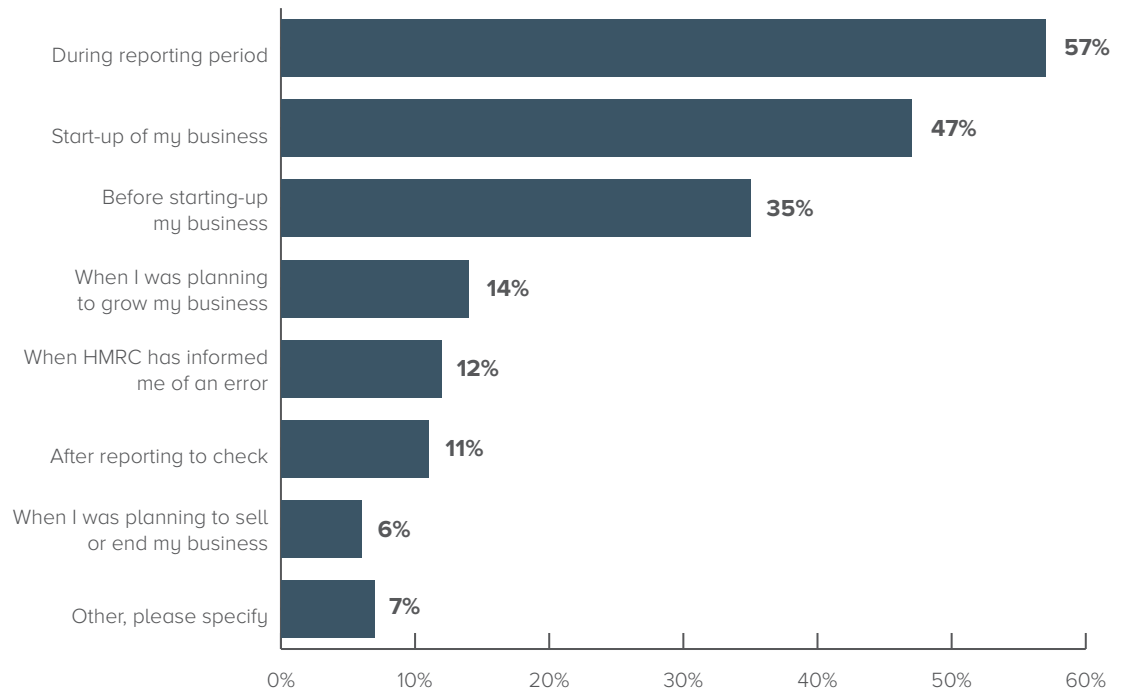
¹⁴ ACCA, SMEs and their Advisers: Measuring Trust and Confidence, 2012.

¹⁵ Interview with member.

Trigger points for seeking advice

The main trigger point for seeking advice seems to be the tax reporting period (Figure 6). Presumably the 57 per cent of respondents that said they seek advice and support at this point do so because they are experiencing difficulties with the process.

Figure 6: Trigger points for small businesses that seek tax advice
Source: FSB taxation survey (2017)



Many business owners also seek advice for more proactive reasons, for example, because they are starting up or because they are looking to grow their business. Nearly half (47%) say they sought advice when they were starting-up their business, and 35 per cent say they sought advice before they started-up. While these are not mutually exclusive groups, it shows at least half of the respondents are taking initiative in seeking advice. Not only does it appear that many businesses are thinking ahead, but they are also seeking advice at different points in their business lifecycles. Most respondents selected more than one answer for the question regarding when they sought external advice.

Planning to grow their business was another trigger point that could be seen as a proactive touchpoint for respondents. Fourteen per cent of FSB small businesses say they sought advice when they were planning to grow their business.

More than one in ten (11%) say they sought advice only after HMRC had informed them of an error. And a similar proportion say they sought advice to check their returns were filled out correctly after they were filed.

Selling or closing a business is another trigger point, but it was only selected by six per cent of respondents. Although many FSB members are serial entrepreneurs, most will not have sold or ended their business yet.

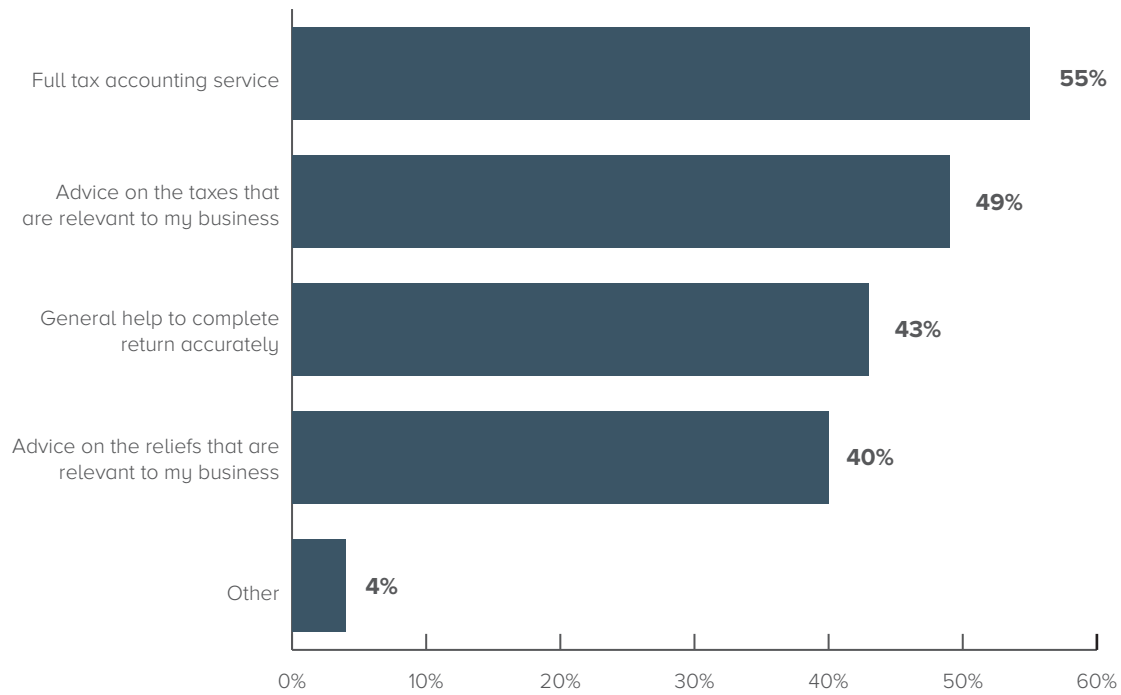
Types of tax advice sought

Many small businesses seek holistic tax advice, with 55 per cent saying they obtain a full tax accounting service (Figure 7). Almost half (49%) of FSB small businesses say they looked for tax advice that was specific to the taxes they pay.

Forty-three per cent of businesses seek help that is related to completing their returns accurately. While a similar number (40%) say they use tax advice to find out about the reliefs that are relevant to their business.

It is clear that many small businesses are interested in reliefs and seek advice about them. But the more popular kinds of advice are focused on immediate concerns, such as ensuring tax returns are completed accurately.

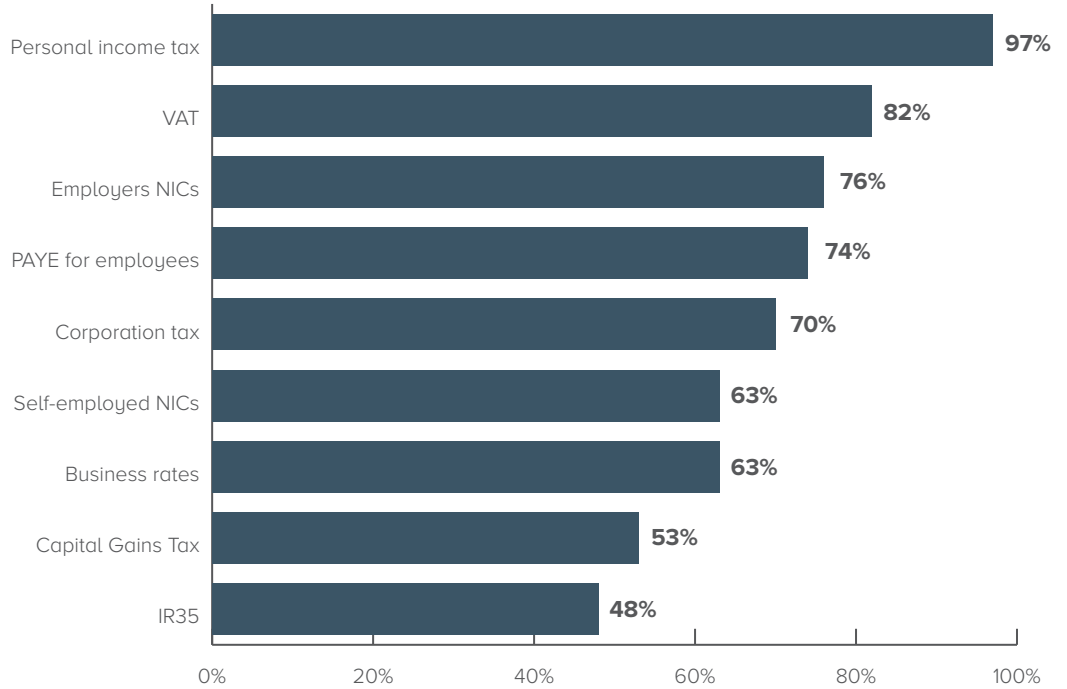
Figure 7: Types of tax advice sought by small businesses
Source: FSB taxation survey (2017)



ASSESSING THE CURRENT TAX SYSTEM

Which taxes are applicable to small businesses?

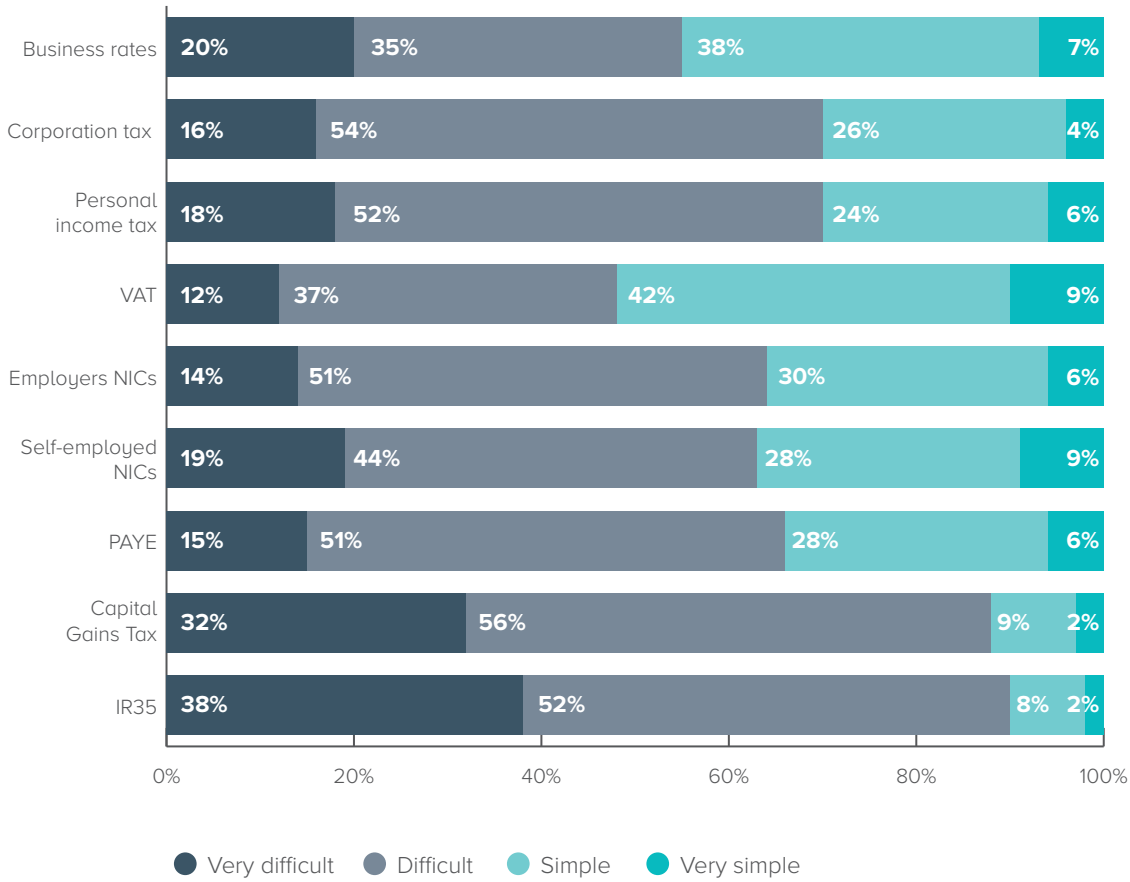
Figure 8: Proportion of small businesses paying different taxes
Source: FSB taxation survey (2017)



Small business understanding of taxation

Many business owners believe that the tax system is difficult to understand. On average, around a quarter believe the taxes they pay are difficult to understand. Only slightly over one in 10 say they find the taxes they pay simple to understand in terms of the instructions they are given when completing tax returns.

Figure 9: Ease with which small firms find different taxes to understand
 Source: FSB taxation survey (2017)



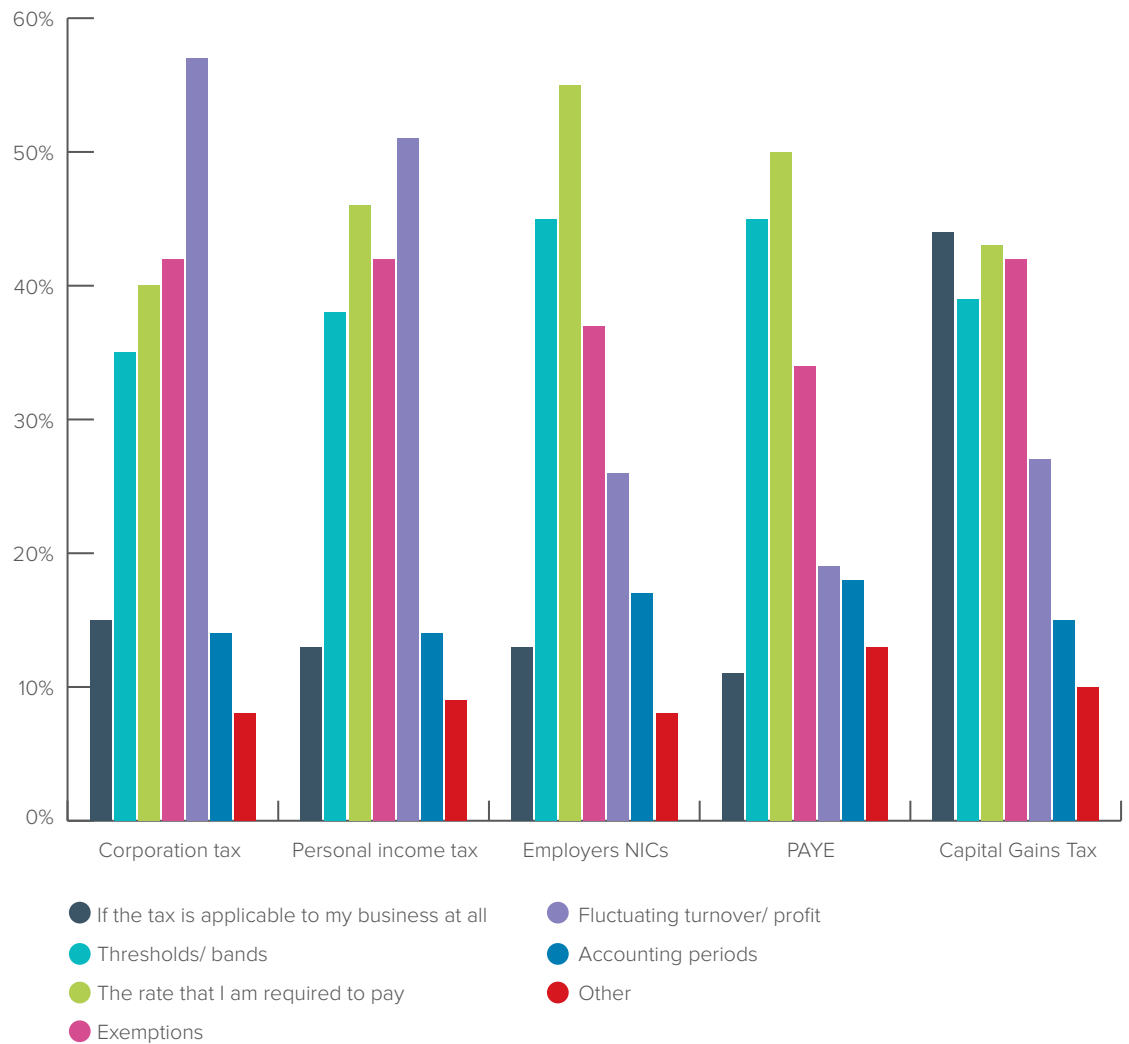
Small businesses find a number of taxes particularly difficult to understand:

- 54 per cent say capital gains tax is hard to understand, while only 7 per cent said it is easy
- Nearly four in ten (39%) say corporation tax is difficult to understand, while only 17 per cent say it was easy
- Similarly, 39 per cent say personal income tax is difficult to understand, while only 16 per cent say it is easy
- A third say PAYE (36%) and Employer NICs (33%) are difficult to understand

When respondents were asked what they found most difficult to understand about each of the taxes, there were some common themes (Figure 10). Different tax rates were raised by nearly half of all respondents (46%). They are particularly confusing for those paying Employer NICs (55%), self-employed NICs (54%), business rates (53%) and Pay As You Earn for Employees (PAYE) (50%). A common feature of these taxes is the number of different rates within them.

Exemptions are another common source of confusion for small businesses, raised by 40 per cent of survey respondents across all taxes. As previously mentioned in this report, VAT is reportedly the simplest tax with which to comply. However, VAT exemptions are confusing for 53 per cent of those who pay this tax, a higher proportion than any other tax.

Figure 10: Small business reasons for finding taxes difficult to understand
Source: FSB taxation survey (2017)



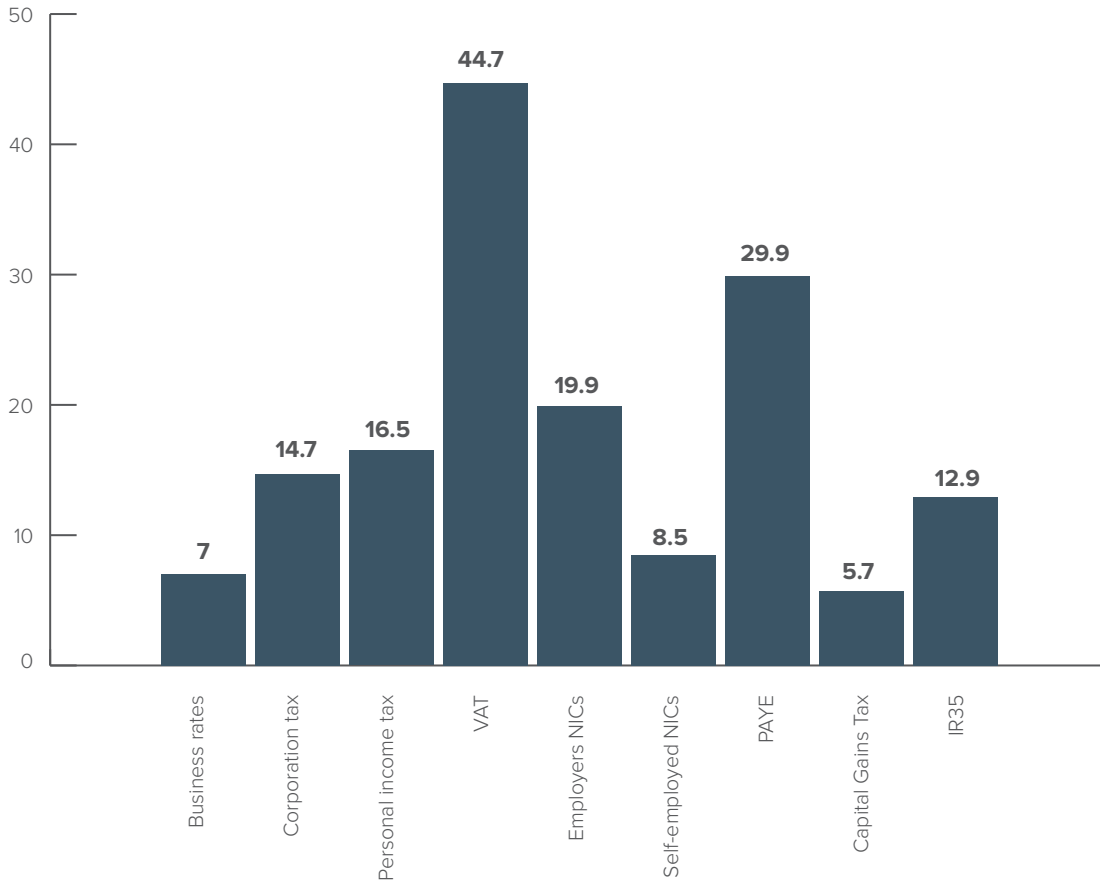
Over a third of FSB small businesses identify thresholds/bands (38%) and fluctuating turnover/profit (38%) as sources of tax confusion. Meanwhile, far fewer businesses (18%) find it difficult to understand if the tax is actually applicable to them or their business, and accounting periods are only flagged by 14 per cent of respondents.

What creates complexity in the tax system, then, is the existence of multiple rates, exemptions and thresholds. The effectiveness of these incentives is explored later in this report. However, it is clear that these difficulties present yet more risk and opportunity for MTD. Ideally, the roll-out of MTD will result in small businesses having to do less of the identifying and categorising of transactions manually, in favour of an accurate, fast and automated process.

Time spent on tax compliance

Whilst difficulty in understanding taxes is critical to shaping the user experience of small businesses, the time it takes to comply with taxes is even more important.

Figure 11: Time spent by small businesses on tax compliance each year (hours)
Source: FSB taxation survey (2017)



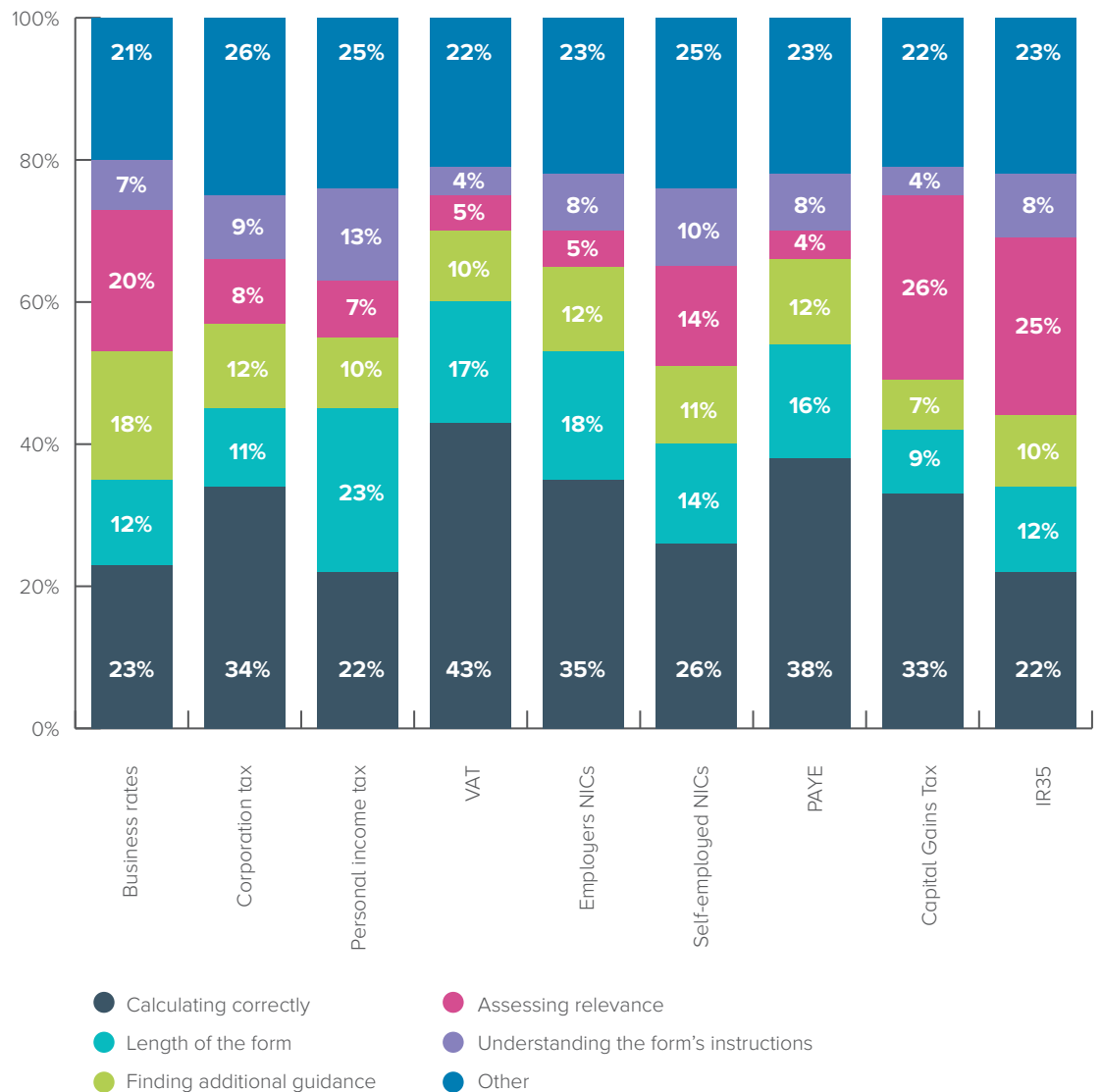
Surprisingly, there is little correlation between the perceived complexity of a tax and the amount of time required to comply with it (Figure 11). For example, FSB small businesses suggest capital gains tax is the most complex of all the taxes. However, they also say it is the least time-consuming tax with which to understand. Conversely, VAT is perceived to be one of the least confusing taxes to understand, but by far the most time-consuming to comply with. So, complexity is not the only thing that takes up a small business owner’s time when complying with taxation.

On average, small businesses that have not sought external advice spend five hours a year more complying with tax. And those that find paying their taxes more time-consuming are generally more likely to have paid their taxes late. However, the data does not suggest a direct link between the use of a tax specialist and the rate of late payment.

Opportunity cost of tax compliance is the key problem. And it is more acute for the smallest businesses. If the business owner is managing tax compliance themselves, using an employee who wasn’t otherwise hired for that job, or employing someone specifically for accounting and tax purposes, the consequence is that resources are reduced for the firm’s core, productive tasks. This not only has an impact for the individual and their business, but also the wider economy.

VAT clearly contradicts the assumption that the more complex a tax is to understand, the more time-consuming compliance will be (Figure 12). On average, FSB small businesses spend 44.7 hours every year complying with VAT requirements. This is by far the most time-consuming of the nine taxes examined in this report. Those that comply with PAYE as employers report spending 29.9 hours every year doing so, and Employer NICs payers spend 19.9 hours adhering to requirements.

Figure 12: Time-consuming aspects of tax compliance for small businesses
 Source: FSB taxation survey (2017)



Calculating the amount of tax due is the most time-consuming aspect of the compliance process for all taxes (with the exception of personal income tax). This is particularly the case for those calculating VAT, with 43 per cent saying calculation is the most time-consuming aspect of complying with this tax.

The number of VAT exemptions may explain why compliance with this tax – which small businesses suggest is relatively simple to understand – is so time-consuming. Exemptions are time-consuming, but not related to conceptual complexity.

Processes related to VAT compliance

The Office of Tax Simplification (OTS) explains some of the reasons users of the system have found it very time-consuming:

“A number of technical areas are considered which have been long-standing irritants to users of the system and where there is significant potential for simplification in either the short or longer term. In undertaking this work the OTS has encountered a range of the extraordinary anomalies in VAT. For example, many will remember the debates involved in determining that a Jaffa Cake is a cake (zero-rated for VAT) rather than a chocolate-covered biscuit (taxable). Every day when using a fast food outlet, you will be asked if you are ‘eating in’ (liable to the standard rate of VAT) or ‘out’ (when no VAT is due), on exactly the same sandwich. Even more mystifying, a gingerbread man with chocolate-covered trousers is subject to VAT, but not if it has chocolate eyes.”¹⁶

Therefore, it is not the complexity of the tax code itself that needs to be reduced, but the administrative processes attached to compliance.

Even businesses that comply with their taxes using digital tools and specialist help find VAT time-consuming. The opportunity exists for HMRC to provide digital solutions that address this. By automating some of the categorisation of transactions, for example, MTD could work to benefit small businesses in a tangible, valuable way.

PAYE is another comparatively time-consuming tax and, once again, it is the time spent calculating the tax due which tends to take-up most time. A small business owner described their frustration with a system that, in its current form, simply isn't flexible enough:

“It doesn't work if people take time off sick. Often two or three payroll submissions are needed to input the correct data for the whole month.”¹⁷

FSB Member, Accountancy Firm, Thames Valley

¹⁶ Office of Tax Simplification, Value added tax: routes to simplification, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/657213/Value_added_tax_routes_to_simplification_web.pdf

¹⁷ Interview with member.

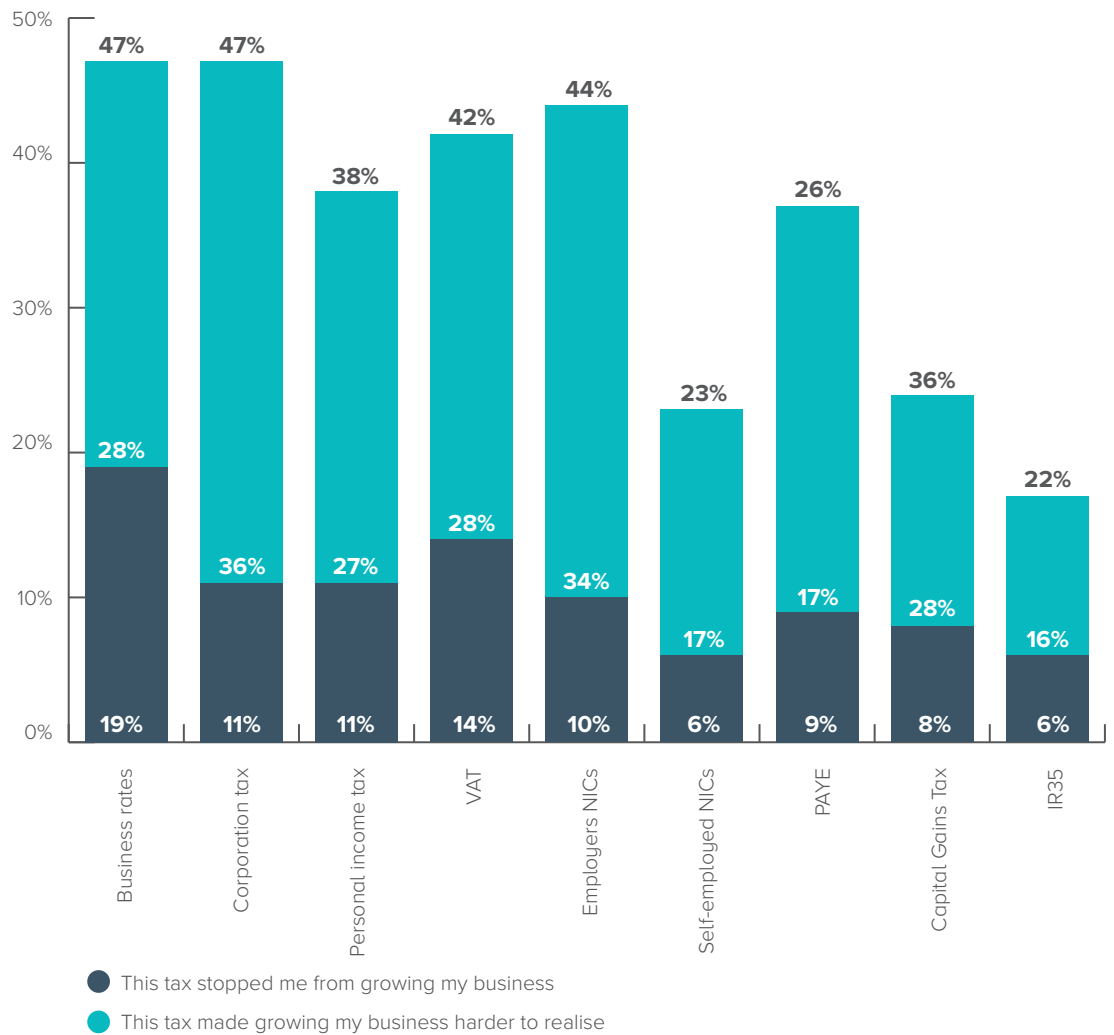
Impact of tax administration on small businesses

Difficulty adhering to tax requirements has a notable impact on most small businesses. A third of small businesses (33%) say that the existence of a tax has stopped them from growing their business. A further third (37%) say the existence of a tax has made business growth harder to realise.

Therefore, tax compliance is having a material negative impact on the growth aspirations of a large proportion of small businesses (Figure 13).

Figure 13: Effect of taxes on small business growth

Source: FSB taxation survey (2017)



The taxes with the highest proportion of small businesses reporting a negative impact on growth are business rates and corporation tax. In both cases nearly half of the businesses say these taxes have either hindered or stopped their growth plans. When analysed in greater detail, it is clear that business rates have created a significant barrier to small business growth, as nearly one in five (19%) say that the levy has stopped them from growing their business.

VAT has the second highest proportion (14%) of small businesses reporting that the tax has stopped business growth. The aforementioned OTS analysis of VAT compliance, alongside FSB’s own data, shows why many small businesses may be deterred from exceeding the VAT threshold.

OTS analysis supports FSB’s view that VAT prevents growth for many businesses:

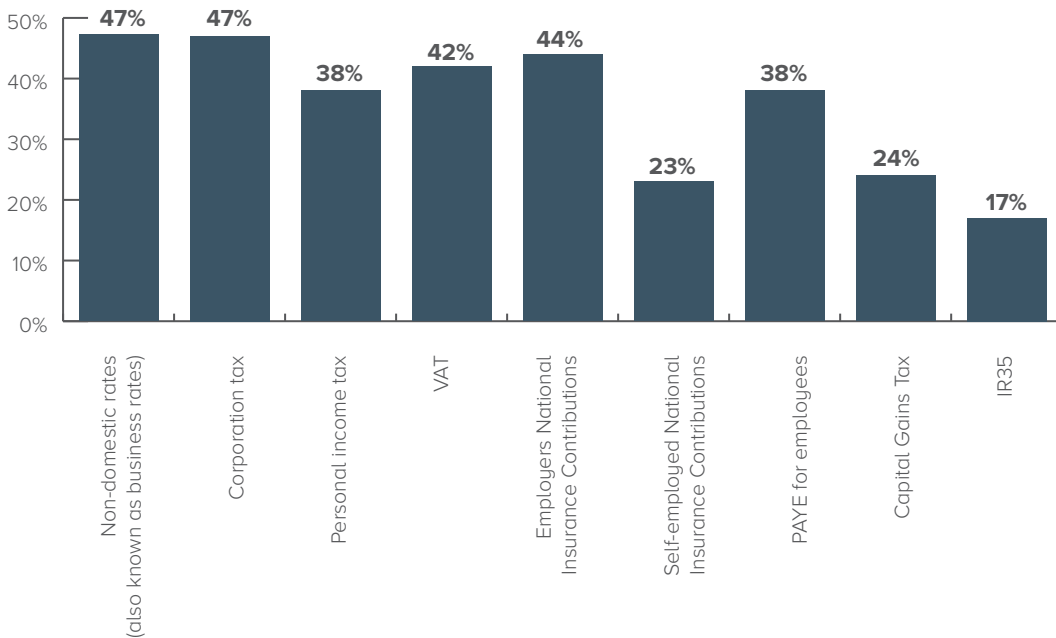
“There is currently significant ‘bunching’ of businesses whose turnover is just below the threshold, particularly businesses with lower levels of inputs relative to supplies to consumers - such as labour-intensive businesses, and businesses operated by sole proprietors - for whom this bunching effect has the appearance of a cliff edge. Some businesses limit expansion – for example by not taking on an extra employee, or an extra contract, or closing their doors for a period, to keep their turnover below the threshold.”¹⁸

Some have argued that this justifies lowering the VAT threshold significantly, in order to remove the cliff edge effect. However, this would mean possibly requiring hundreds of thousands more small businesses to be subject to the arduous burden of VAT compliance. These smaller businesses will likely be even less capable of completing VAT returns efficiently in their current form. They will more acutely feel the loss of resource caused by having to comply with the most time-consuming business tax in the UK. Rather than shifting the turnover threshold, the Government should be focusing on improving the user experience of VAT compliance.

Employer NICs and PAYE also had a fairly high proportion of payers describing them as a hindrance to growth (44% and 38% respectively).

Figure 14: Proportion of small firms reporting that a tax made growth harder to realise or stopped growth completely

Source: FSB taxation survey (2017)



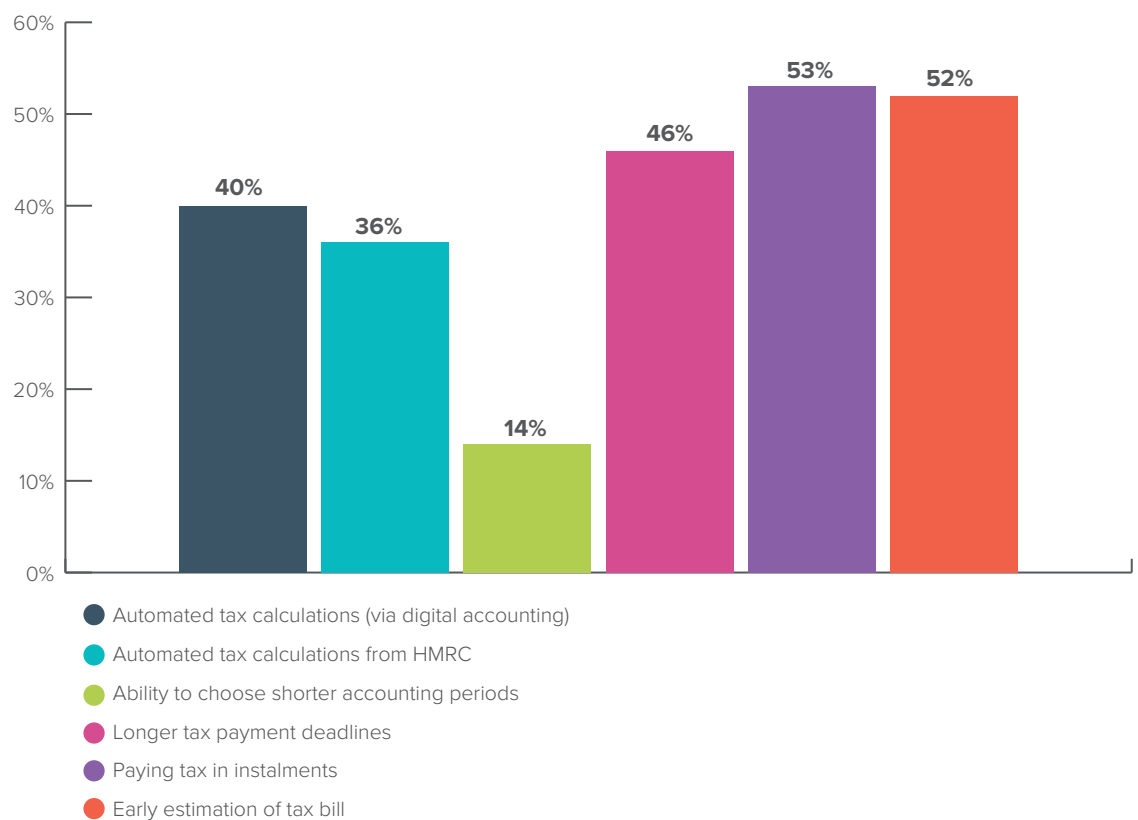
¹⁸ Office of Tax Simplification, Value added tax: routes to simplification, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/657213/Value_added_tax_routes_to_simplification_web.pdf

Simplifying the compliance process

FSB research has identified where small businesses believe straightforward improvements can be made to the time-consuming tax compliance process (Figure 15).

Over half (53%) of FSB small businesses say the option to pay taxes in instalments would be useful. Again, over half (52%) also suggest that early estimation of their tax bill would be useful. Both of these options are related to addressing the cost of the tax itself, or how a business meets that cost, rather than the process, complexity or time-consumption of complying with it.

Figure 15: Useful tax solutions for small businesses
Source: FSB taxation survey (2017)



Just under a half (46%) of FSB small businesses say longer tax deadlines would be useful. This, again, reinforces the idea that planning for and meeting the expense of the taxes is the paramount concern for most businesses.

It should be noted that, after FSB members were surveyed for this report, the Government announced a change to how late payments would be dealt with by HMRC. The Autumn Budget Red Book revealed a points-based system,¹⁹ similar to that used with driving licenses. This will replace the outgoing system, which added an immediate £100 fine to late submissions for tax returns. Now, a further £10 fine is incurred from HMRC for each day without payment after the deadline. After three months, these fines increase in severity until up to a year, by which point a businesses' tax bill can be more than doubled by late payment fees.²⁰ While these fines are severe enough to act as a deterrent to non-compliance, they also unnecessarily punish those that have genuine difficulty navigating a complex and strict tax system. The Government's new traffic light system is a welcome step forward, as it gives a business owner the opportunity to learn from their mistakes before striking them with a costly fine.

¹⁹ Autumn Budget 2017 Redbook, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661480/autumn_budget_2017_web.pdf

²⁰ Which? £100 penalty for late tax returns to be scrapped, <https://www.which.co.uk/news/2017/12/100-late-fee-for-tax-returns-to-be-scrapped/>

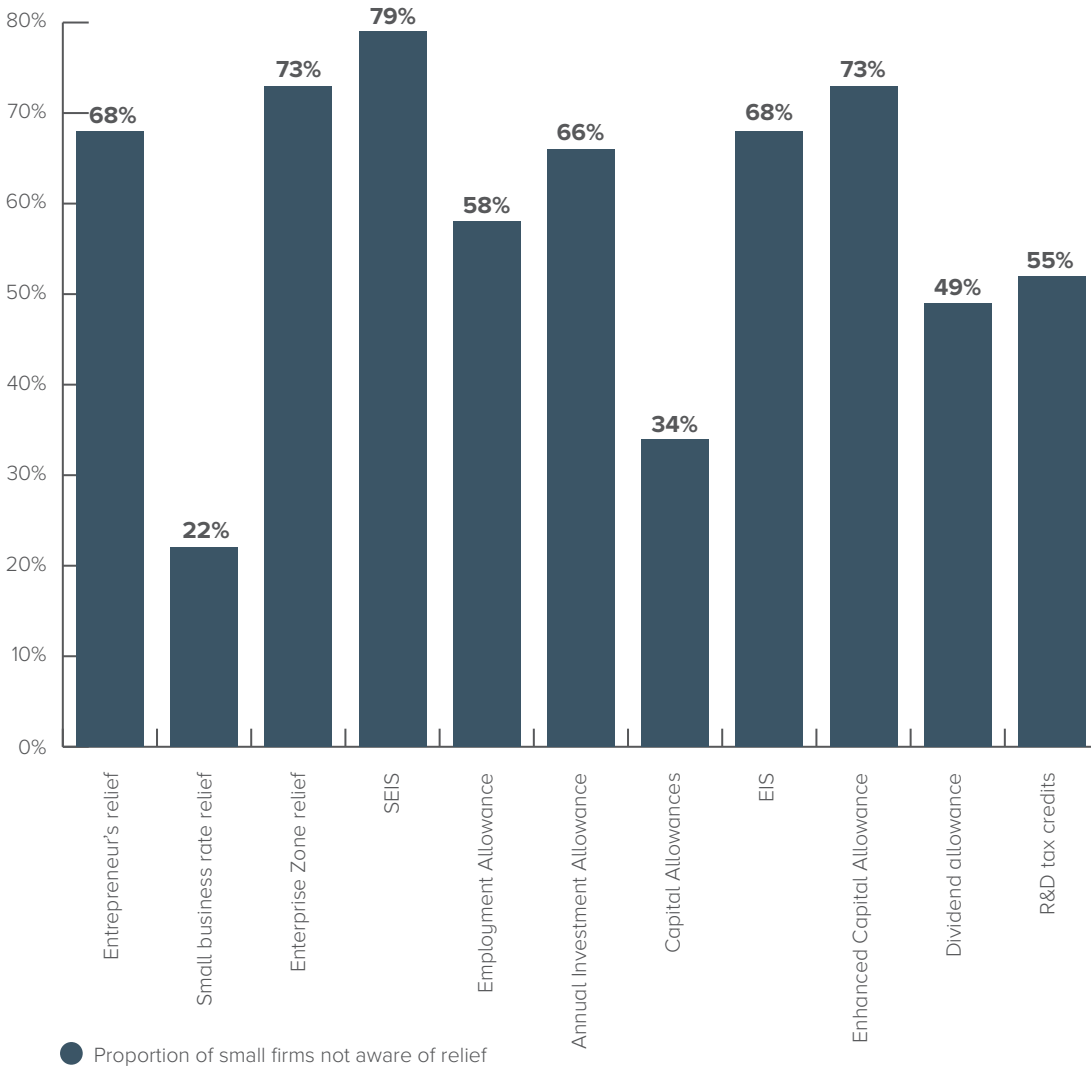
ACCESSING TAX RELIEFS

Small businesses tend to have a broad exposure to tax, so are often entitled to a range of tax reliefs. In this section of the report, we examine the awareness and effectiveness of the most common small business tax incentives.

Generally, small businesses have low awareness of potentially available tax reliefs (Figure 16). Of the 10 reliefs assessed in this report, over half (58%) say they are not aware of reliefs.

There is, however, a great degree of variance in awareness between different reliefs, reflecting typical business activity. The highest level of awareness is among those that accessed small business rate relief. This is a relief on business rates applying to any business with a premises below a certain Rateable Value (RV). It would be a logical presumption that a large proportion of the small business community would be aware of, and in receipt of, this relief.

Figure 16: Awareness of tax reliefs among small businesses
Source: FSB taxation survey (2017)



Awareness of capital allowances is also relatively high, with 65 per cent of FSB small businesses saying they are aware of its availability and 37 per cent saying that they had accessed it. Capital allowances allow a business to offset the expense of some investments in capital goods. Over half of FSB small businesses are also aware of the dividend allowance.

For other tax reliefs, levels of awareness start to drop below half. Employment Allowance, Dividend Allowance and Research and Development tax credits are better known than Enterprise Zone relief, EIS and SEIS. These lesser known reliefs are applicable to fewer businesses.

There are a number of patterns that emerge from the data. For example, it is interesting that the proportion of business owners that are aware of the Employment Allowance relief is far lower than the proportion of the sample that report being employers.

Employment Allowance is a relief that operates under the radar for some small businesses. It is universal and, given that 70 per cent of FSB members are employers, awareness should be high. It is critical, therefore, that such reliefs are broadly promoted.

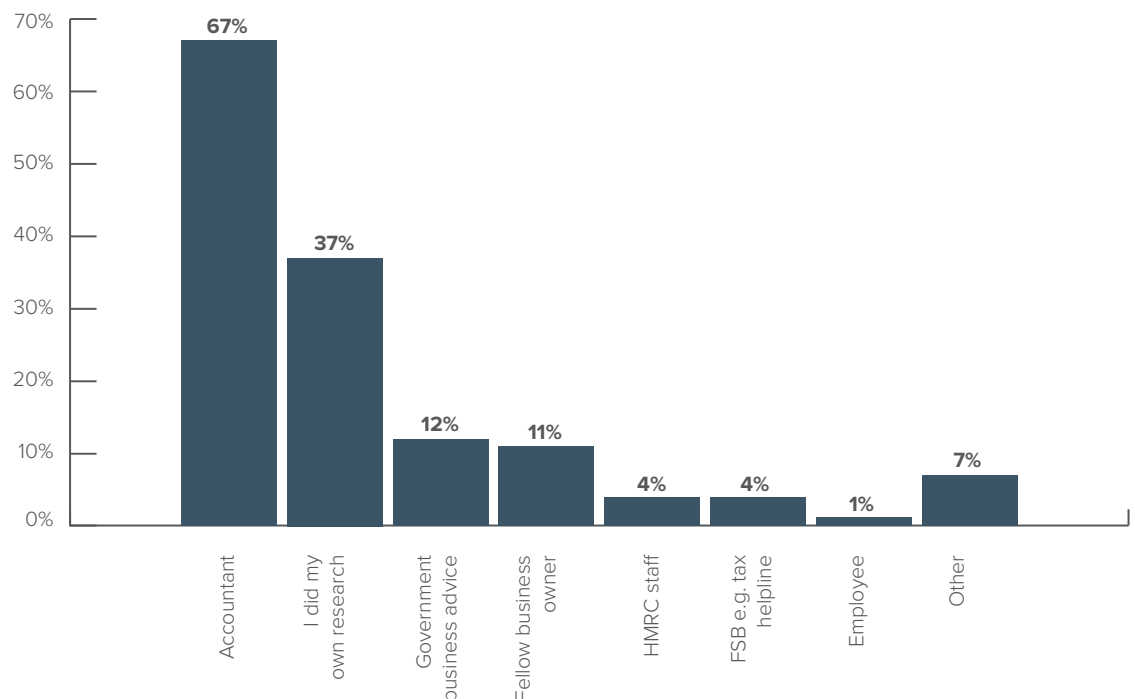
The reliefs with the lowest level of awareness among small businesses tend to apply to just a small section of the business community. For example, both EIS and SEIS only apply to businesses that are seeking equity finance for growth, which will be a very small proportion of the small business community. Similarly, the Enterprise Zone relief will only be applicable to a small proportion of small businesses.

Where do small businesses find out about tax reliefs?

The majority (55%) of small businesses say they do not feel well-informed about tax reliefs despite the fact that their information comes from a variety of sources. Of those that have some level of awareness about tax reliefs, most (67%) say they found out about them from their accountants (Figure 17). More than a third (37%) say they researched tax reliefs themselves. A much lower proportion (12%) found out about reliefs through government advice, while a similar proportion (11%) found out from other business owners.

Small business awareness of tax reliefs might be limited by the fact that many rely heavily on an accountant, who may themselves not have the full picture. The next most popular route to advice is their own research rather than other external actors. There is clearly a role for the wider business support community to play.

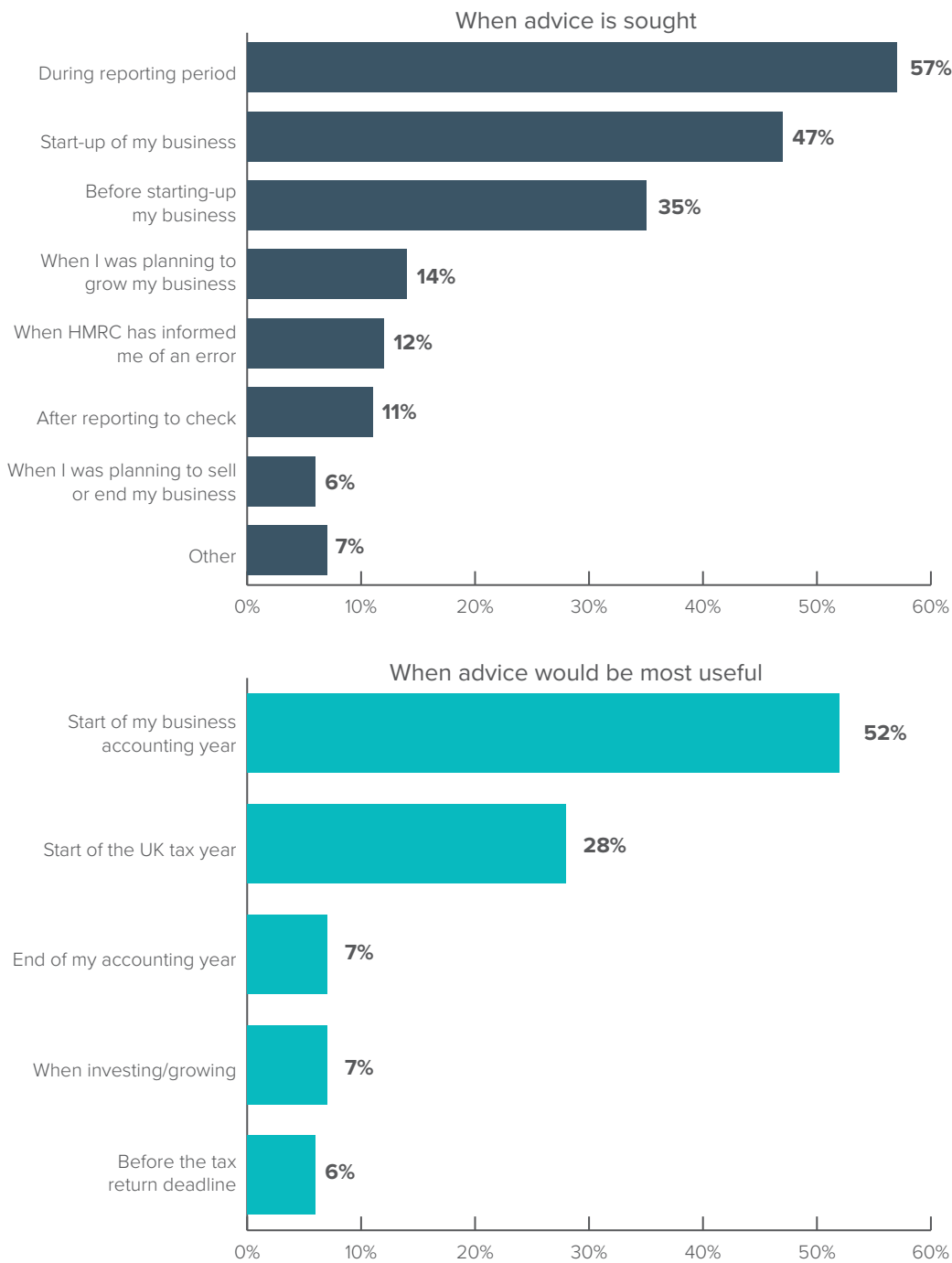
Figure 17: Sources of information about tax reliefs for small businesses
Source: FSB taxation survey (2017)



When do small businesses find out about tax reliefs?

Figure 18 shows that many small businesses seek advice from external advisors (predominantly accountants) at the point of, or before, starting-up their business. Later, they seek external advice when tax returns are due. Only 14 per cent of businesses sought advice when they were considering growing their businesses. This is a significant obstacle to the awareness and uptake of reliefs.

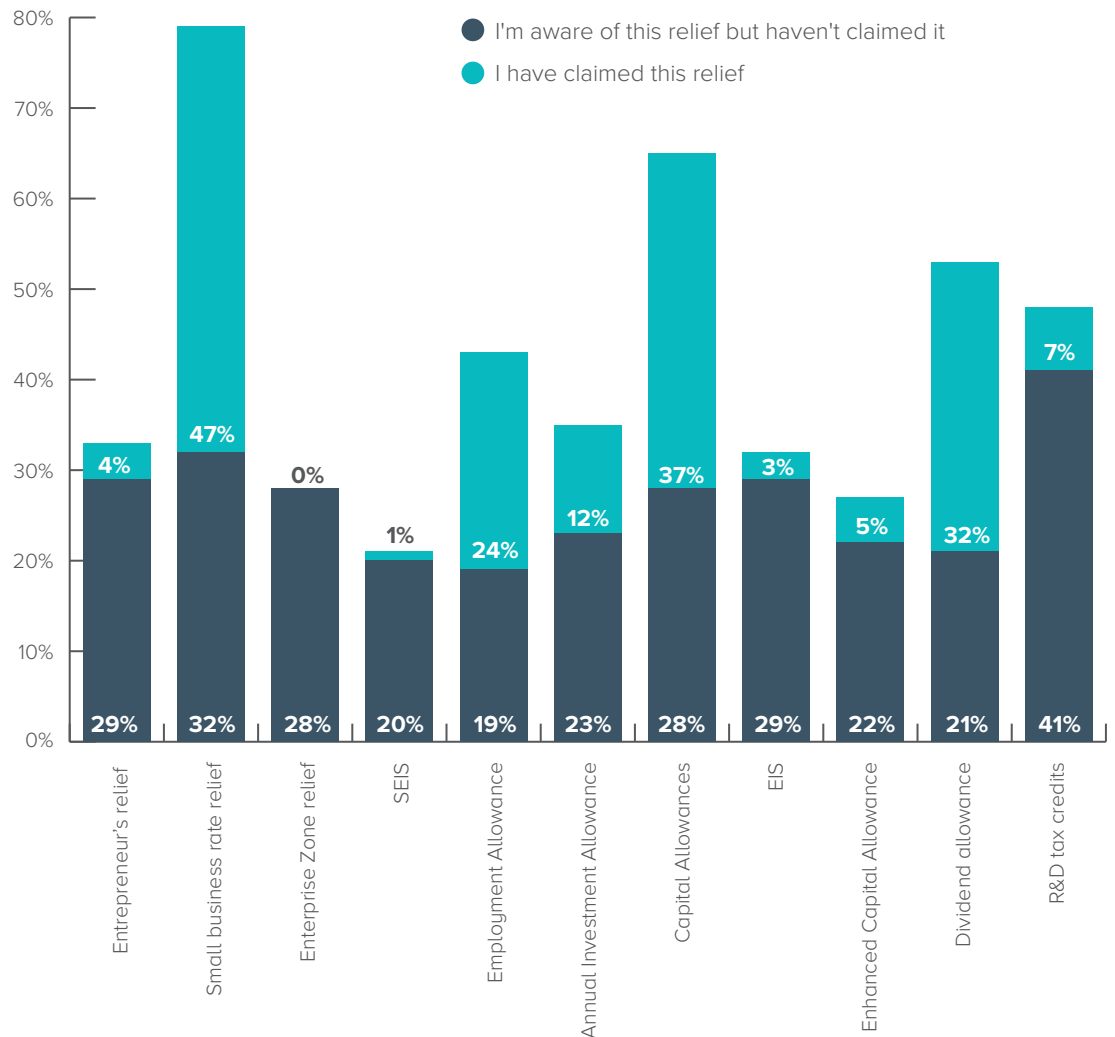
Figure 18: Trigger points for seeking advice about tax reliefs versus most useful trigger points for advice
Source: FSB taxation survey (2017)



TAKE-UP OF RELIEFS

The level of take-up of reliefs reflects awareness, although R&D tax credits stands out as being a relief that doesn't follow this pattern (Figure 19). Although 41 per cent of FSB small businesses say they are aware of this relief, uptake remains low (just 7%).

Figure 19: Small business awareness and uptake of reliefs
Source: FSB taxation survey (2017)



There are other examples of a disconnect between knowledge and uptake of a tax relief. For Entrepreneur's relief, a third of respondents (29%) are aware of its existence, while only four per cent use it. The reason for this is clear. Entrepreneur's relief applies to capital gains tax which would only impact a business when they are selling assets.²¹ Many business owners may intend to use this relief at the end of their businesses' lifecycle, but most currently operating businesses would not be eligible for this relief.

There is low awareness, and particularly low uptake, of both of the enterprise investment schemes (EIS and SEIS). But they are only applicable to small businesses that are accessing equity finance. The wider impact of these reliefs must be considered when determining their effectiveness. EIS and SEIS are designed to help develop the equity finance market. By driving incentives for investors in early stage businesses that aspire to scale-up, it is hoped that more investors and businesses will be attracted to this method of sharing and gaining investment. And thus far the evidence suggests that this relief has been successful in making this a reality.

21 House of Commons Library, Capital gains tax: background history Standard Note: SN860 Last updated: 2 June 2010 Author: Antony Seely Business & Transport Section.

At the other end of the spectrum, there are a number of tax reliefs that have high rates of take-up. Business rate relief and capital and dividend allowances are received by more than half of the businesses that are aware of them.

Drivers of and barriers to tax relief take-up

Uptake of reliefs appears to be driven by a number of factors. The most important of these is whether or not the relief reduces a large tax bill. This is clearly the case for business rates. Some small businesses save thousands of pounds through business rates relief. In some cases, this is perhaps enough to allow businesses with tight margins to be profitable.

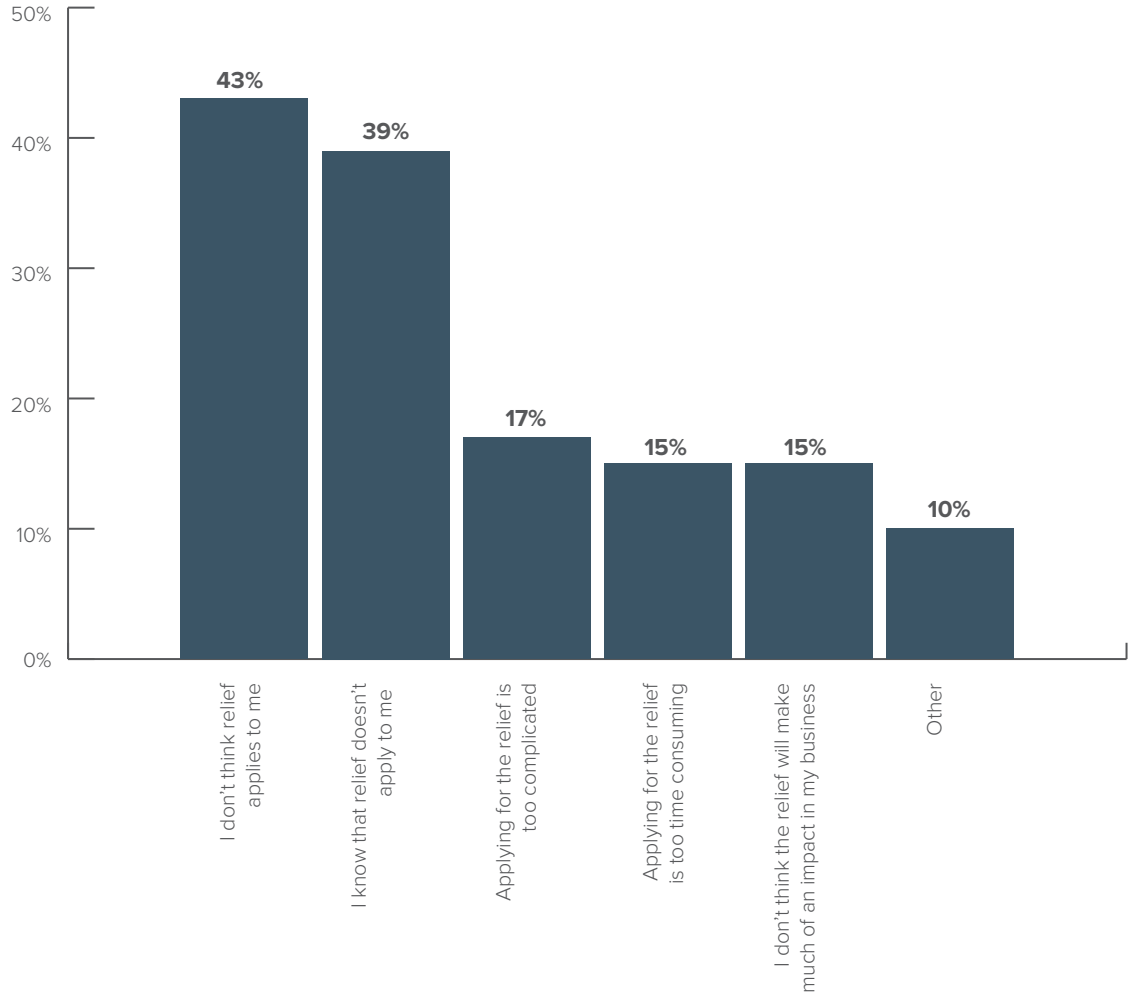
Capital allowances allow businesses to offset a proportion of expenditure on what are often costly investments. Again, the value of the tax relief alone is likely to drive uptake, and the fact that buying capital goods is something businesses regularly engage in means most business owners are likely to be aware of, and eligible for, the tax relief.

The next driver for high uptake is the breadth of eligibility. The eligibility criteria for capital allowances is fairly broad. Capital expenditure on goods that fall in to the plant and machinery categorisation makes up the largest proportion of the capital allowance relief spend. The terms ‘plant’ and ‘machinery’ are not strictly defined in legislation, but guidance is provided by HMRC. Many of the things a business purchases, that are not considered stock for selling on, are likely to be considered a capital good and, therefore, eligible for relief. The same breadth of eligibility is true of business rates.

Dividend taxation also has a high level of awareness and uptake among small businesses. Again, it has broad eligibility. Most owners of incorporated businesses will often choose to pay themselves in dividends as well as a salary. This gives them more flexibility as a business owner; the ability to leave money in the business when necessary and take additional profits when they believe it is the right time to do so. The allowance has very few qualifying requirements and all business owners will be entitled to this relief below the £5000 (£2000 from April 2018) threshold.

Some businesses are clearly discouraged from taking-up tax reliefs, despite being aware of them (Figure 20). In many cases, an information deficit appears to be holding back access to reliefs. While small business awareness of tax reliefs appears to be quite low generally, it is not the only problem. It appears that even those businesses that are aware of certain reliefs are not well-informed about them. A large proportion (43%) of small businesses who are aware of, but not in receipt of, tax reliefs believe the reliefs do not apply to them. However, many had not sought additional information to confirm this. Forty-three percent of small businesses say they do not “think” a certain relief applies to them, while a smaller proportion (39%) said they have not applied for a relief they are aware of because they “know” it does not apply to them.

Figure 20: Barriers to tax relief take-up for small businesses
 Source: FSB taxation survey (2017)

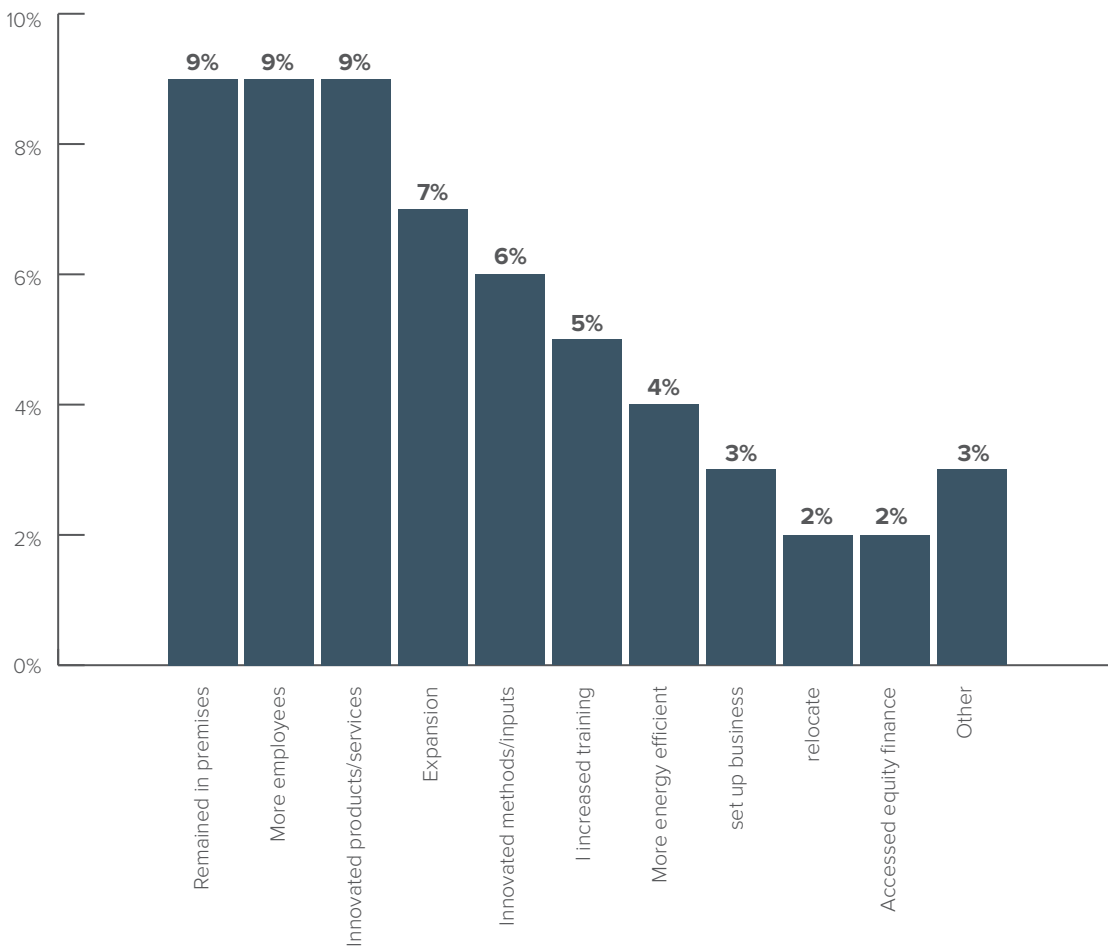


It appears many small businesses are ill-informed, even about the reliefs they are aware of. Many are not aware of the full range of reliefs that might apply to them and, even if they have heard about reliefs, many of them assume they are not applicable to their business without seeking further information and advice.

IMPACT OF RELIEFS

A large proportion of small businesses report that tax reliefs have little impact on their behaviour. However, we believe this may well be because of when they receive the advice i.e. they have already made growth and investment decisions which the reliefs subsequently support (Figure 21). However, for many small business owners, access to reliefs appears to play a vital role in the operation of their business. Nine per cent of business owners say access to business rate relief has allowed them to remain in their premises. The same proportion say tax reliefs directly help them to hire more employees. Nine per cent also say they have been able to increase their levels of investment in innovation of their products and services.

Figure 21: Impact of tax reliefs on small business behaviour
Source: FSB taxation survey (2017)



Essentially, many small businesses find that the reliefs they access have little impact on their behaviour. However, for a sizeable proportion, reliefs are absolutely vital to the operation of their business. Neither of these audiences are likely to change their behaviour.

Perhaps, when a business is starting up, being informed of certain reliefs will encourage increasing ambitions for investing or employing, but it is likely that they have already made plans to do these things.

One of the most common points of contact for advice about small business tax reliefs is when a tax return is due. Being informed about a relief at this point rewards businesses for past behaviours. However, it is less likely to influence future plans at this point. Small businesses need to be informed about potential tax reliefs when they are making their future plans rather than when the tax year is over.

Employment Allowance: an example of the challenges to maintaining effectiveness

Employment Allowance was a success when it was launched in April 2014. It provided a relief for employers on the Employers National Insurance Contributions for their first employee. By 2015, small businesses reported that it had driven increased wages and recruitment. At this time, awareness of this relief was high, with 73 per cent of eligible businesses saying that they had claimed it. However, since then, awareness of Employment Allowance has fallen, with more than a quarter of eligible businesses now saying that they are unaware of its existence, compared to 13 per cent just three years ago.

When it was launched, Employment Allowance was well-communicated to eligible businesses. Since then, however, Government has reduced the promotion of the allowance and, as a result, awareness has dropped. Without this awareness, the impact on behaviour and business decision-making could also decline.

It seems there is room for improvement to ensure that small business tax reliefs effectively drive positive behaviour change. Good advice is critical. However, too many businesses appear to only hear about reliefs in retrospect. Instead, the existence of tax reliefs should be integral to discussions about a business' growth and productivity aspirations.

Improving effectiveness of reliefs

FSB data shows that many small businesses are not taking advantage of the tax reliefs that are available to them. Small businesses appear to lack the internal expertise to be well informed about the broad suite of tax reliefs.

The evidence appears to point to three main factors that drive an effective tax relief. First and foremost is awareness. Awareness of many reliefs is fairly low, and there are cases where small business owners may be aware of, but not well-informed about, a relief. Many appear to be assuming reliefs do not apply to them without seeking further information to verify this.

The second main driver is value. If a business owner is aware that a particular relief will save them a significant amount on their tax bill they are, of course, more likely to attempt to access the relief. This is evidenced by the high uptake and reported effectiveness of business rates relief. Business rates bills might otherwise have resulted in some businesses moving premises, but the relief allowed them to stay. While this may not be an active change in behaviour, it does mean that business owners are better able to focus on other aspects of their business, rather than having to relocate. Conversely, some reliefs may not make a significant difference to small businesses, meaning take-up remains low.

Finally, ease of access drives the degree to which a relief makes an impact. Specifically, the more complex and time-consuming a relief is deemed to be, the less likely a business is to attempt to access it. Seventeen per cent of small businesses did not apply for a relief that they were aware of because they felt applying for the tax was too complicated and 15 per cent said that they thought the application process would be too time consuming.

Being the primary problem, awareness of reliefs should be the first issue that government and the business community tackles. Accountants are a well-trusted and common route for business owners to get advice on a broad range of issues. It seems that there needs to be greater and broader input in raising awareness of reliefs for small businesses. Making Tax Digital may, again, provide some answers to this issue, but this is ultimately a long-term vision. More needs to be done to inform intermediaries in the short to medium-term. The system could potentially leverage information about the taxes a firm is paying and alert a business to relevant reliefs.

Ensuring firms are made aware of reliefs at the right time is also essential. Most businesses appear to be finding out about reliefs at the end of the tax year when it is too late to impact behaviour. Input is needed from Government and business support organisations to provide information about reliefs when business owners are making growth plans (i.e. at the point at which the reliefs are most likely to impact behaviour).

The UK's business support system is rich with options for businesses at a variety of different stages in their lifecycles. This expertise could be better harnessed in order to drive up the effectiveness of tax reliefs. Tax reliefs have the potential to give further assistance to any business that is looking to invest, innovate, access equity finance, employ more people or become more energy efficient. Currently, many businesses are doing these things without the available support of government. In England, Growth Hubs are especially well-placed to disseminate much of the information about tax reliefs, as they are very visible to most businesses.

RECOMMENDATIONS

User experience

1. Government should prioritise efforts to simplify the process of small business compliance with the existing tax system, rather than seeking complex legislative changes to the UK tax code.

Reviews of the UK tax system tend to address the length of the tax code and potential difficulties associated with language and inconsistencies. FSB wants to shine a light on the practical difficulties that small businesses face when it comes to tax compliance. VAT is an example of this, where many small businesses say they understand the tax well enough, but the process of compliance is still by far the most time-consuming compared to other taxes, taking an average of 45 hours per year.

For many small businesses, time and resources are at a premium. Onerous tax compliance creates opportunity costs for these businesses, leading to lost output for the wider economy. Disproportionate compliance burdens inevitably increase the likelihood that mistakes are made by small businesses, which itself makes tax collection costlier to the Exchequer and increases the occurrence of late payment of taxes. Therefore, by looking at the issue of tax simplification through the lens of user experience, Government will be better able to address issues of non-compliance and late tax payments.

Certainty is incredibly important for small businesses, and must not be overlooked or underestimated. The Treasury's business tax roadmap²² has provided a welcome step in terms of providing some certainty for smaller businesses. However, there needs to be a renewed commitment to the concept of planning ahead in relation to taxation and providing certainty for businesses.

Think tanks, business groups and other researchers need to assess the complexity of the UK's tax system in a way that reflects what really matters to businesses. The primary consideration should be the length of time required for a small business owner to complete a tax return accurately.

2. Government must ensure that the design and development of Making Tax Digital (MTD) focusses on the user experience of small businesses, addressing current compliance difficulties while ensuring the system itself does not create additional complexity.

FSB research has previously demonstrated some of the difficulties that many small businesses will face in adopting digital recording and reporting.²³

For this reason, FSB welcomed the announcement in July 2017 that quarterly mandatory digital tax reporting would only apply to those small businesses above the VAT threshold. However, successful implementation of this policy will require investment from both the Government and businesses.

This report exposes the ways in which the current tax system hinders small business success and, therefore, the efficiency of the wider economy. Government should prioritise addressing pinch points in the current taxation system and preventing new ones from occurring by testing thoroughly with businesses of all sizes, including the solo self-employed. Government also needs to innovate to create solutions to small business tax compliance challenges:

- Government should ensure that MTD software is designed with a variety of small businesses in mind. A wide selection of businesses of different sizes, including the solo self-employed, should be included in its testing. VAT is the first tax that MTD is mandated for. In this regard, the primary metric of success or failure should be the ability of MTD to reduce time spent by businesses complying with this tax.
- MTD also has the potential to address other small business tax difficulties, such as forecasting their overall liability.

²² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/509249/business_tax_road_map_final2.pdf

²³ FSB & PWC Implementing Making Tax Digital: International evidence of the challenges for small firms, November 2016, <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-mtd-pwc-report.pdf?sfvrsn=1>

- Roll-out of MTD should not be rushed. Many countries have taken several years to roll-out digital tax solutions.²⁴ The Government's timeline should remain flexible and not overly ambitious.
- The Office of Tax Simplification (OTS) should have a role in reviewing the system throughout its development and implementation. This will help to ensure businesses experience a significant reduction in their administrative burdens as a result of MTD.

3. The Government should continue to pursue a voluntary approach to uptake of Making Tax Digital for businesses below the VAT threshold.

The Government should learn the lessons from the introduction of digital tax systems in Australia and Finland, ensuring a voluntary rather than a mandatory approach to MTD and quarterly tax reporting. There is a significant gap between the current digital capabilities of many small businesses and the digital skills needed to use quarterly tax reporting systems. In addition there could also be accessibility issues for many taxpayers in remote areas who do not have effective internet connections. Upskilling and supporting businesses to cope with the challenges of adopting new digital technologies needs to be the immediate priority. Depending on a firm's existing resources, stage in its business journey or age of its proprietor, culture change can be a slow process. Forcing businesses to adopt new methods they are not comfortable with is more often than not counter-productive.

4. Government should work with software providers to ensure that more affordable accounting software is available to small businesses.

Digital accounting software will be essential for the delivery of MTD. Particularly for small businesses below the VAT threshold and not mandated to comply with MTD. Many of these are being discouraged from voluntary uptake of MTD by the cost of accounting software.²⁵ Whilst there are a small number of free accounting software solutions, knowledge of – and access to – them is still limited. FSB research shows that of those small businesses that do not use accounting software, a quarter cite the cost of software as being the main reason. Government needs to ensure that these small businesses are exposed to the full range of software providers. Government must also ensure there is sufficient support for software companies seeking to deliver cost free options. It is vital that Government promotes a deep market across a range of different software providers, to ensure strong competition and lower costs.

5. Government should increase HMRC capacity to provide direct advice via its web-chat, telephone and email services.

FSB research shows many small businesses are unable to access specialist advice or tax services, and are therefore put at a disadvantage. These businesses lack advice that would help them with their tax affairs. They may also be less efficient as they spend time on tax compliance that would ideally be spent on core business activities. The Government's own advice and guidance services play a vital role in bridging the gap, but have been found to be lacking in quality by some.²⁶ Many businesses report being unable to reach knowledgeable HMRC advisors after long waiting times. The customer support system needs to be boosted with greater investment, particularly in services that provide direct support, such as the HMRC call centre and online chat service.

²⁴ FSB & PWC Implementing Making Tax Digital: International evidence of the challenges for small firms, November 2016, <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-mtd-pwc-report.pdf?sfvrsn=1>

²⁵ Ibid.

²⁶ HMRC monthly performance update: December 2017, 1 February 2018, <https://www.gov.uk/government/publications/hmrc-monthly-performance-report-december-2017/hmrc-monthly-performance-update-december-2017>

Reliefs

6. Government should promote greater awareness of the tax reliefs available to small businesses.

Business owners generally lack awareness of the tax reliefs that are available, or potentially available, to them. On average, less than half of small business owners were aware of the 10 tax reliefs explicitly investigated in this report. Some reliefs will clearly not be relevant or applicable to all small businesses. However, more broadly, FSB evidence shows that awareness of tax reliefs amongst small businesses is not as high as it could be, meaning the desired effect of these reliefs are not being realised.

For those small businesses that are aware of tax reliefs, some do not access them because of a lack of information or advice. Government (particularly HMRC) should ensure that reliefs are flagged at the relevant touchpoints with small businesses. Making Tax Digital (MTD) should harness data gathered from small businesses to identify and flag potential reliefs. This would add value to the investment in MTD and support small business growth by encouraging take-up of reliefs at appropriate stages in a small business' lifecycle.

7. Government should give Growth Hubs in England (and their equivalents in Scotland, Wales and Northern Ireland) a central role in providing information about appropriate small business tax reliefs.

Growth Hubs are accessed by thousands of businesses and they often provide information to businesses who are aiming to grow. Ensuring that Growth Hubs are well-informed about the range of tax reliefs available to small businesses will help to raise awareness.

While the focus of Growth Hubs is to drive growth and enhance the productivity of small businesses, they should also seek to inform a business about other interventions, including reliefs that can support their growth and productivity aspirations.

8 Business groups, accountants and banks – alongside other informed intermediaries – should play a greater role in directing firms towards tax reliefs, at the right times in their lifecycle.

It is essential to use the wider business ecosystem to support interventions to encourage strategic growth. It is not only Government that has a role to play in encouraging increased take-up of reliefs. Business groups, accountants and bank relationship managers are often considered trusted agents by many small business owners and looked upon as a good source of advice. However these actors need to be equipped to advise on the widest range of applicable reliefs to small businesses, at the right points in their lifecycle. Government and business groups should look at how this could be best achieved. Small businesses should receive advice about tax reliefs at the start of a new tax year and other touch points associated with forward planning. This will ensure that tax reliefs are integrated into strategic growth plans, including investment decisions. Advice for business start-ups should contain information about what tax reliefs might be available to them and where to get more information.

METHODOLOGY

The FSB tax survey was conducted with members across the UK. Individuals were invited to participate in the survey via email and social media channels. The survey was administered by the research agency Verve and was in the field from 29 September to 20 October 2017. The survey questionnaire was completed by a total of 1,071 small businesses.

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