KINGSTON
UNIVERSITY

Analysis of the Impact of the Tax System on the Cash Flow of Small Businesses: A Report for HM Revenue and Customs (HMRC)

Professor Robert A. Blackburn, Professor Mark Hart, Professor David Smallbone, Dr John Kitching, William Eadson and Kristy Bannon

ISBN No. 1-872058-83-3
Date: November 2005

Kingston Business School
Kingston University
Occasional Paper Series No 58

Contents

List of Tables & Figures

Acknowledgements

The authors would like to thank the following for their help in the research and analysis for this report. We are grateful to HMRC for commissioning this research project and the advice of the Steering Committee. In particular, we would like to thank Anwar Hussain and Brian O'Callaghan for their encouragement and guidance on the project and analysis of the results. Our thanks go to Robin Jarvis at the ACCA for his help with the research and hosting the focus group. We are also grateful to IFF for undertaking the telephone survey. Valerie Thorne at the SBRC provided help with secretarial and typing assistance and Richard Hyde helped with the Tables. We would also like to thank the key stakeholders who took part in the focus group and helped us develop the telephone and face to face interview schedules. Finally, we would like to acknowledge the invaluable contribution of the owner-managers, who took part in the telephone and face-to-face surveys, for giving up their valuable time to be interviewed.

Professor Robert Blackburn
Professor Mark Hart
Professor David Smallbone
Dr John Kitching
William Eadson
Kristy Bannon

Small Business Research Centre
November 2005

Executive Summary

- Small firms are now regarded as central to the economy, with those firms employing less than 50 people contributing 99.3% of all enterprises, 46.8% of employment and 37.0% of turnover in the UK.

- This report presents evidence on the effects of the timing of taxation payments on the cash flow of small firms. Specifically, it seeks to examine the effects of the timing of taxation payments, both negative and positive, on cash flow; identify which particular types of businesses are affected; the effects of taxation according to different types of taxation (such as VAT and Corporation tax); and the take-up of government initiatives related to taxation payments.

- The main primary research for this report was undertaken in May-July 2005 and comprised a focus group and interviews with key informants, a telephone survey and face-to-face interviews with 27 owner-managers. Analysis of the results included interview summaries and transcriptions of the face-to-face interviews together with the use of SPSS and STATA for the telephone survey results. The response rate for the telephone survey was 53%.

- Our *a priori* reasoning suggested that the impact of the taxation system would be mediated by a variety of business contextual, process and performance factors. Thus, whilst it is accepted that the small firms are distinctive from larger organisations, it would be unrealistic to anticipate homogeneous effects of the timing of taxation payments across the range of small firms.

- The focus group and interviews with key stakeholders provided important information for both scoping out the main survey research as well as providing evidence in its own right. Small firms were said to have relatively little power in negotiating with larger organisations over credit terms. They were also less likely to possess strong internal financial management and were more likely to be under-capitalised. External accountants were considered to be important 'influencers' on the way in which small firms manage their finances, advising on strategic and operational decisions and providing information. These factors were considered important when examining the impact of the timing of tax payments and owner-managers' responses.

- The survey of 875 small firms was undertaken in May/June 2005 and the results were weighted to the UK population of businesses with these characteristics. The results are therefore representative of the smaller firm population employing less than 50 people.

- The sample of firms was mainly reliant on bank overdrafts, personal savings and re-invested profits for their working and investment capital. This is typical of this population of firms. The smaller firms in the sample were more likely to use personal savings whilst larger firms were more likely to use re-invested profits.

- There was a mixture of financial performances in the sample. Almost 38% reported increased sales in the previous 12 months, just over a quarter reported a decline and a third said they had stayed the same. However, seven out of 10 were profitable in the previous 12 months. Again there was

diversity in the sample according to business context including size, sector and legal status.

- Small firms are often criticised for their weak financial management. This survey could not corroborate nor refute this stereotypical view. A third of the businesses employed a book-keeper and one in 10 an in-house accountant. We estimate that the majority of firms (60.9%) employ neither. The survey highlighted the use of external accountants. The majority (89%) used a professionally qualified accountant to help complete their tax returns.

- Cash flow problems were considered quite rare or an occasional problem by two-thirds of the sample. The main reported cause of cash flow difficulties in the past year was late payment (31.3%) followed by fluctuations in income and outgoings (20.4%). Having to pay all of a particular tax in one lump sum was reported by 13.3%. Cash flow problems were particularly associated with firms reporting variable and unpredictable sales.

- Business owners used a variety of sources to cover cash flow difficulties but these tended to be concentrated on using a bank overdraft, personal savings and delaying payment to suppliers. Only a few businesses (5.8%) reported not paying tax on time.

- The analysis of the impact of taxation on cash flow focused on four main areas of taxation: VAT, PAYE and NICs, Corporation tax, and personal taxation and NICs

- Almost three-quarters of the businesses were registered for VAT. The most popular method of payment was quarterly on invoices raised (82.9% of VAT registered businesses) followed by the Cash Accounting Scheme (15.0%). This choice of payment method was based mainly on the grounds that it was their 'usual method' followed by 'convenience' and 'recommendation by accountant'. There was an uneven awareness of the variety of methods of payment available although higher awareness did not necessarily equate to higher take-up.

- Paying VAT presented a critical or major cash flow problem for less than one in five (17.8%) and no problem at all or a minor cash flow problem for eight out of 10. Those businesses operating within a wider context of permanent cash flow problems were more likely to report VAT as causing problems.

- Almost a half of the businesses (44.1%) paid PAYE and NICs for employees. The most popular timing of these payments was monthly (69.3%) followed by quarterly. Paying PAYE and Employer NICs were not found to cause or contribute to cash flow problems and of all the taxes studied had the least reported detrimental effects on cash flow. This may be related to the frequency of payment.

- Over a third of businesses (34.7%) were limited companies and eligible to pay Corporation tax. The bulk of businesses paying Corporation tax paid on the due date although a minority (14.3%) paid late and 14.5% paid early. Compared with other taxes in the study Corporation tax was most likely to generate cash-flow problems for the business. Almost a quarter of businesses (23.2%) reported payment as causing a critical or major cash flow problem. This was particularly the case in Construction firms and those that were more reliant on cash sales.

- Payment of employers' personal income tax and NICs was undertaken by self-assessment (51.2%) and/or PAYE (20.0%). Personal income tax was paid twice a year by 42.3% and once by 24.3%. National insurance payments tended to be more in line with the payment of PAYE on a monthly basis. Personal income tax and NIC payments presented critical or major cash flow problems for only a minority of businesses (14.7%).

- The bulk of businesses (72.1%) reported putting the cash raised for taxation into their ordinary bank account, and 18.9% into a separate account. However, recognition of cash flow benefits associated with the collection of taxation prior to payment was not widespread. Two-thirds of owner-managers perceived no benefit to cash flow by having cash available because tax payments are made some time after accrual. The reason for this lower than expected perceived benefit ranged from the small amounts involved through to the administrative costs associated with the effort of being unpaid tax collectors.

- Almost a quarter of businesses paid one or more taxes electronically (22.8%). The most common rationale for making on-line tax payments was 'greater convenience' (63.1%). 'Saving time' and 'cheaper' were however reported as reasons by less than 5.0% of respondents. Electronic payment of taxes was highest for personal income tax/national insurance contributions (13.2%) followed by PAYE (17%) and VAT (9.1%).

- Almost a third of owner-managers (31.0%) reported difficulty in meeting a taxation payment deadline and over a quarter (26.6%) had received a penalty or fine. This was most likely to be for not meeting a personal income tax or VAT deadline. Owner-managers tended to resolve difficulties in meeting a taxation deadline by using a bank overdraft followed by re-negotiating payment terms with tax authorities, delaying payment to suppliers and using business savings.

- Owner-manager suggestions for improving the timing and method of payment of taxation included being able to make payment in several instalments rather than a lump sum. To some extent this reflects the finding in the sample that those payments that tend to have to be paid frequently tend to generate fewer problems.

- A series of multivariate models were undertaken to establish the range of independent influences on the likelihood of a small business reporting that they find the payment of a particular tax affecting their cash flow. There are some common associations that emerge across all four models as well as some specific relationships. The multivariate analyses show that when controlling for other factors, it is not the very smallest firms which are experiencing taxation payment problems; there are also sectoral effects; and sole proprietorships and partnerships are more likely to report taxation problems.

- Having controlled for a set of business characteristics (size, sector, age and legal status) the analysis highlights the inter-relationship between how sales are generated, late payment and financial performance and reported cash flow problems associated with tax payments.

- Although the main conclusion to be drawn from the research is that the timing of tax payments do not necessarily generate cash flow problems, certain businesses under certain conditions are affected. Indeed, the timing of taxation payments and the ability to pay was shown to be inextricably linked with the financial conditions of the business at that time

- There appear to be both broad and specific implications of the research. Broadly, the research suggests a need to help small firms tackle late payment and bad debt more effectively. This may involve the use of intermediaries such as accountants. Specifically, there needs to be a raising in the depth and scope of communication between small firms and HMRC to improve the procedures for payment methods and their take-up.

Chapter One: Introduction and Research Objectives

1.1 Research Objectives

This report presents evidence on the effects of the timing of taxation payments on the cash flow of small businesses, commissioned by HMRC and undertaken by the SBRC, Kingston University. 'Cash flow' in this respect relates to the operating capital of the enterprise rather than investment capital. The tax system here refers to the timing of payments rather than the payments themselves or the rates of taxation.

Specifically, the objectives of the research will:

(i) *Identify the effects* of the timing of taxation payments on small firms. This will involve an investigation of how these payments interact with the existing finances and financial management structures and practices in small firms.

(ii) Provide *empirical evidence* on the positive and negative effects of the tax system on cash flow. For example, to what extent does delayed payment of taxation provide the enterprise with additional short-term cash to put to use within the business or otherwise?

(iii) *Unpack* the cash flow problems created or exacerbated by the tax system, focusing on:

- The significance of these problems relative to other non-tax factors (e.g. credit terms, late payment, debt collection arrangements, poor financial management, inadequate planning). The *type of businesses* which are more likely to be affected based for example, on their size, sector, age, processes and management of cash flow. This may allow us to develop a profile of the businesses most likely to experience the effects of the tax system on their cash flow.

- The *effects* of taxation according to different types of payments, such as VAT (which is collected) as opposed to those that are calculated and then paid (corporation tax).

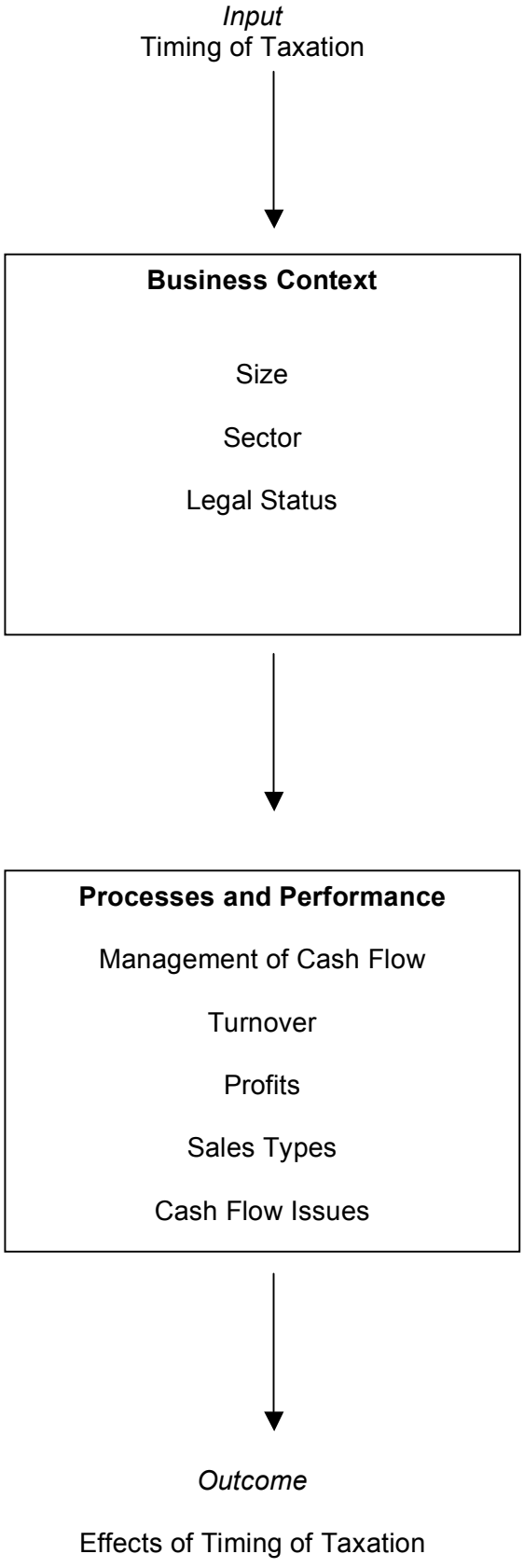
- The effects on *business growth and development*

(iv) Identify why some *government initiatives* aimed at assisting businesses in their payments of tax and ameliorating the effects on cash flow, are not used more widely. This can help feed back into understanding the efficacy of such schemes as the Inland Revenue's 'certificate of deposit' or the HMCE's VAT cash accounting and VAT annual accounting schemes.

1.2 Conceptual Framework

Our a priori reasoning suggests that the impact of the taxation system will be mediated by a variety of contextual, process and performance factors (Figure 1). Hence, the assumption is that although small firms are distinctive form larger firms and organisations, there are also differences within this population. The timing of tax payments is both a cause and consequence of these contextual, process and performance factors. The timing of tax payments will be conditioned structurally by, for example, the sector within which the business operates.

Figure 1: Conceptual Framework



However, other firm specific factors will also influence this outcome including the internal processes of the enterprise (e.g. Cash flow management) and its financial performance (e.g. Access to resources). Understanding the effects of the impact of the timing and methods of payment of taxation is complex, not least because of the demands made on an already existing cash-flow 'regime' in the business. Our analysis, using a combination of qualitative and quantitative data seeks to address and explain these interactions. From this approach it may be possible to extrapolate findings to the broader population by identifying which businesses and under what conditions will be affected by the timing of taxation payments.

1.3 Structure of the Report

Chapter 2 of this report provides an explanation of the methods and analytical approaches used in the collection of primary data. Chapter 3 provides an important background analysis on the finances and financial management practices of the surveyed firms. Chapter 4 analyses the cash flow issues facing small firms. Having set out the key contextual and performance factors, Chapter 5 then discusses the effects of the timing of tax payments on small firms and the differences within the sample. Given the complexity already noted in identifying precise relationships between business characteristics and the effects of a particular tax payments Chapter 6 uses a series of multivariate models to establish the range of independent influences on the likelihood of a small business reporting that they find the payment of a particular tax affecting their cash flow. The final Chapter provides some key issues for consideration in helping the taxation system work better for smaller firms.

Chapter Two: Methodology

2.1 Introduction

In order to address the research questions outlined in Chapter One, a three-stage research design was adopted to generate both quantitative and qualitative data relevant to the research objectives.

The three stages involved:

- a focus group and interviews with knowledgeable informants
- a telephone survey of 875 small business owners
- a face-to-face interview sample of 27 business owners

For each of these stages, we discuss sampling, data generation and data analysis issues.

2.2 Focus Group/Interviews with Knowledgeable Informants

Given the limited evidence base concerning small business owners' tax payment practices, it was important to scope out the key issues prior to conducting the main study. To identify the issues the study would need to address, a focus group of private sector accountants and tax specialists and interviews with 10 key informants were conducted. The focus group was recorded and a summary of the discussion provided (Appendix 1). The key issues identified by focus group participants were fed into the design of the research instruments used for both the telephone survey and the face-to-face interview study.

2.3 The Telephone Survey

The purpose of the telephone survey was to collect data from a wide variety of business owners in order to be able to generalise across the small business population and to certain segments of that population. As little is known about small businesses with regard to the issues investigated, even descriptive data is of value in building up a picture of how the method and timing of tax payments impinges upon business cash flow and how small business owners address these issues.

To be included in the survey, businesses had to meet the following criteria:

- Employment – businesses must employ fewer than 50 people at the time of interview;
- Turnover – businesses must have earned less than £1.5m during their last financial year;
- Independence – businesses must be legally independent entities, that is, not owned by, nor part of, another enterprise;
- Industry – businesses in five broad sectors were included (primary, manufacturing, construction, consumer services, and business services);
- Location – businesses were located in the four countries of the UK.

For the telephone survey, target quotas were established for businesses by sector and employment size (Table 2.1). Quotas were established to ensure that sufficient subsample numbers would be sought for each size/sector combination and also to ensure the weighting fractions to be applied to specific cases in order to generate the results would not be too great and possibly lead to unrepresentative results.

Table 2.1

Telephone Survey: Target Quotas					
	Employment Size (banded)				
Industry Group	1-4	5-9	10-19	20-49	ALL
Primary/utilities (SIC groups A-C)	25	15	5	5	50
Manufacturing (SIC group D)	25	35	30	20	110
Construction (SIC group F)	50	25	20	20	115
Consumer services (SIC groups G, M, N)	100	100	75	30	305
Business services (SIC groups I, J, K)	100	100	70	25	295
ALL	**300**	**275**	**200**	**100**	**875**

Note: sample businesses were allocated to a Standard Industrial Classification (SIC) 2003 group. SIC groups are as follows:

- Primary/utilities - Groups A-B, agriculture, hunting and forestry; fishing; Group C, mining and quarrying;
- Consumer services - Group G, wholesale and retail trade; repairs; Group M, education; Group N, health and social work;
- Business services - Group I, transport, storage and communication; Group J, financial intermediation; Group K, real estate, renting and business activities.

Business owner respondents were identified using a commercial database providing details of principals' names, business names, addresses, telephone numbers, industry, employment and turnover information. Businesses were selected to meet the quotas shown in Table 2.1. Once checks had been made to ensure the business satisfied the criteria outlined above, interviews were conducted. A market research company was contracted to conduct the telephone interviews. The overall response rate was 53%.[1] Interviews were conducted between May-June 2005. The average length of the telephone interviews was 21 minutes. The final number of achieved interviews and business characteristics are shown in Table 2.2. The results of the survey for each question are shown in Appendix 2.

[1] Response rate was calculated as follows: achieved interviews/(achieved interviews + refusals).

Table 2.2

Characteristics of Telephone Survey Enterprises			
	Weighted %	**Weighted N**	**Unweighted N**
Employment Size			
1-4	92.3	807	324
5-9	4.7	41	261
10-19	2.3	20	216
20-49	0.7	6	74
Turnover			
Under £58,000	35.0	307	128
£58k-£149,999	31.3	273	170
£150k-249,999	15.9	140	139
£250k-£659,999	11.4	100	242
£660k-£999,999	2.9	26	91
£1m +	1.7	15	84
No data	1.8	16	21
VAT Registered			
Yes - registered	72.5	634	750
No non-registered	27.1	237	121
No data	0.5	4	4
Legal Status	%		
Self employed sole trader	48.6	426	240
Partnership/LLP	16.6	145	171
Ltd company	34.7	303	457
Other	0.1	1	6
No data	0	0	1
Sector	%		
Primary	4.7	41	48
Manufacturing	7.8	69	122
Construction	20.6	180	120
Consumer Services	34.7	304	282
Business Services	32.2	281	303
ALL		**875**	**875**
Notes: (1) unweighted Ns are the raw sample figures; weighted data and Ns were calculated using the weighting fractions reported in Table 2.4; (2) frequency counts of zero are due to weighting. (3) some weighted percentages do not sum to 100% due to rounding.			
Source: telephone survey.			

2.4 The Face-to-Face Interview Sample

The purpose of the face-to-face interviews was to provide qualitative data on business owners' cash management and tax payment practices, their motives for those practices and their experiences of making tax payments. The aim of this phase of the study was not to produce statistically generalisable results but rather to understand business owners' practices in context, to provide deeper insights into how and why owners acted in the ways they did in the circumstances within which they operated. The topic guide used for the interview study is provided in Appendix 3.

The selection criteria for inclusion in the face-to-face interview sample were broadly similar to those for the telephone survey, with one exception. Given the time constraints, the location criterion was relaxed. The research team focused primarily on the Kingston/South-West London area to construct the sample. Details of the face-to-face sample businesses are provided in Table 2.3.

The face-to-face interview sample was constructed using a variety of data sources.

- Kingston Chamber of Commerce
- Wandsworth Council
- The FAME database
- Forum for Private Business
- Personal contacts

Table 2.3

Characteristics of Face-to-Face Interview Sample Enterprises		
	N	**%**
Employment Size		
1-4	11	40.1
5-9	9	33.3
10-19	4	14.8
20 or more	3	11.1
Legal Status		
Sole proprietor	5*	18.5
Partnership/LLP	4	14.8
Ltd company	19*	70.4
Sector		
Primary	0	0
Manufacturing	2	7.4
Construction	4	14.8
Consumer Services	8	29.6
Business Services	13	48.1
Eligible for tax payments		
VAT Registered	23	85.2
Corporation Tax	15	55.6
PAYE	24	88.9
Personal tax/NICs	26	96.3
ALL	**27**	
Notes: (1) one business employed 78 staff with a turnover of £3.5m. (2) one respondent (starred *) operated two businesses, one a sole proprietorship and one a limited company; both are recorded here.		
Source: Face-to-face interview sample.		

2.5 Data Analysis

The quantitative data were analysed using SPSS 12 and STATA. To provide UK small business population estimates, the data were grossed up using weights derived from DTI business stock figures (Table 2.4). Given, the specific sector/size sub-samples achieved, this inevitably means that the findings from smaller businesses are weighted more heavily and those from larger businesses weighted less heavily than their presence in the sample. All results tables presented in the report are weighted, except in the multivariate modeling.

Table 2.4

Telephone Survey Weightings				
	Employment Size (banded)			
Industry Group	1-4	5-9	10-19	20-49
Primary/utilities (SIC groups A, B, C, E)	1.85295	0.09811	0.04315	0.03235
Manufacturing (SIC group D)	1.85220	0.12008	0.09284	0.08911
Construction (SIC group F)	3.86577	0.15096	0.04821	0.04215
Consumer services (SIC groups G, H, M, N, O)	2.42516	0.22464	0.15961	0.13328
Business services (SIC groups I, J, K)	2.31214	0.12313	0.06902	0.06162
Source: derived using DTI business stock estimates and actual sector/size subsamples achieved.				

In the tables we have reported respondents' replies faithfully. In some cases, respondents have given replies which on reflection appear highly unlikely to be true, for example, making annual PAYE payments for staff (see Table 5.5, p68 and surrounding discussion).

The qualitative data was analysed for key themes. The purpose was to explore how particular business owners managed their tax payments in particular circumstances, and why they chose to act in particular ways rather than otherwise. The findings do not suggest that a particular proportion of small business owners will act in particular ways but rather that, in certain conditions, they will face particular pressures which have to be interpreted and managed.

Chapter Three: Finance and Financial Management in Small Businesses

3.1 Introduction

One of the key underlying propositions in the research proposal was that the impact of taxation on cash flow in small businesses is likely to vary between firms, influenced by the way a business is managed, as well as by the strength of its performance. Management actions and processes, in this respect, refer specifically to behaviour that affects the way that cash flow is managed. For example, it might be expected that where specialist financial management expertise is drawn upon, taxation issues might be more efficiently managed, with less impact on cash flow. This financial expertise may be provided internally, where businesses employ a professionally qualified accountant, or a book-keeper, in-house; or, by using an external accountant to prepare the tax returns. Similarly, efficiency in cash flow management might be reflected in a higher propensity for firms to make use of computer software for managing finance, which in turn, might suggest a lower propensity to report negative impacts of taxation on cash flow.

Other factors that might be expected to affect the impact of taxation on cash flow include the way in which the business is financed and business performance. For example, an over-reliance on internal sources of finance might be associated with more cash flow problems and a higher propensity of firms to report negative impacts of taxation on cash flow. Similarly with respect to performance, it might be hypothesised that businesses with weak performance, in terms of sales and profitability, may find it more difficult to make tax payments, because their performance is impacting on cash flow within the firm. In such circumstances,

business owners may tend to blame taxation payments for their cash flow problems, rather than their weak business performance.

In this context, the main role of this chapter is to provide a descriptive profile of sampled businesses in terms of aspects related to firstly, management actions or processes; and secondly, business financing and performance. The specific indicators used to describe management actions and processes, with respect to financial management are: whether or not firms have access to specialist financial expertise, such as an accountant or book-keeper; and secondly, whether or not any tax payments are made electronically and, if so, the rationale for this. With respect to business finance and performance, the main indicators are firstly, the main sources of finance used by businesses, during the last two years; and secondly, the performance of the business during the last financial year, in terms of sales turnover and profitability. Respondents were also asked about their expectations concerning the performance of the business during the next 12 months.

3.2 Responsibility for Cash Flow Matters

One of the characteristics of small firms that distinguish them from larger organisations is their more limited internal resource base, which offers less scope for employing experts with specialist management skills. This is potentially important, since it might be expected that the use of professional assistance in the completion of tax returns would help to minimize any negative impacts of tax payments on a firm's cash flow. In this regard, the survey revealed that: 33.4% employed a book-keeper or similar; 9.1% employed an accountant in-house (Table 3.1). Since 3.4% employed both an accountant and a book-keeper, this means that 39.1% employed an accountant and/or a book-keeper in-house. The converse is that a majority of firms (60.9%) employed neither a professionally qualified accountant nor a book-

keeper, or similar person, in-house, although the use of externally qualified professional assistance with tax returns was more common.

Table 3.1[2]

Accountancy Practices in Surveyed Businesses						
	Business employs an in-house professionally qualified accountant	**Business has an in-house book-keeper or someone other than a professionally qualified accountant**	**Business does all tax returns in house**	**Business prepares tax returns with some external help**	**Tax returns are prepared externally by professional accountant**	**All**
Size	%	%	%	%	%	%
1-4	8.7	30.6	15.0	26.7	58.3	801
5-9	11.9	63.4	9.8	34.1	56.1	41
10-49	15.4	73.1	11.5	30.8	57.7	26
All	9.0	33.4	14.6	27.2	58.2	868
Legal Status	**	***				
Self employed sole trader	6.6	25.5	16.9	24.0	59.0	420
Partnership	15.2	36.6	8.3	22.9	68.8	144
Ltd company	9.6	42.9	14.3	33.6	52.2	301
All	9.0	33.4	14.6	27.2	58.3	865
Sectors	*	*				
Primary	16.3	12.5	12.2	14.3	73.5	49
Manufacturing	10.3	35.9	19.2	23.1	57.7	78
Construction	8.9	38.9	15.6	31.1	53.3	180
Consumer Services	5.4	31.7	15.9	28.7	55.4	289
Business Services	11.6	34.7	12.1	26.1	61.8	272
All	9.1	33.4	14.7	27.1	58.2	868
Financial Performance in previous 12 months						
Made a profit	9.2	33.3	14.7	25.5	59.8	577
Made a loss	13.4	38.4	23.4	22.4	54.2	107
Broke even	3.8	32.1	6.9	32.1	61.1	131
All	8.9	33.8	14.6	26.1	59.3	815

Source: SBRC HMRC Business Survey, 2005

Notes: (i) $^{***}\chi^2$ significant at the 99.9% level; $^{**}\chi^2$ significant at the 99% level; $^{*}\chi^2$ significant at the 95% level.
Ii) In column 1 of the above Table, n=819; in column 2, n=820.

In fact, few firms (only 14.6%) completed their tax returns without external professional help. If those with professional accountants employed in-house are excluded from this group, then only 11.2% of firms completed all their tax returns,

[2] Figures in all tables are calculated discounting any 'don't know' responses or refusals to answer for analytical purposes. As a result some figures will differ from those in Appendix 2.

without professionally qualified assistance. In fact, one of the main findings of the survey with respect to the completion of tax returns is the important role of accountants, since 58% reported using an external accountant for this purpose, and a further 27.2% received some external professional help for this purpose. The conclusion is that whilst the majority of small firms make use of professionally qualified accountants to complete their tax returns, this is typically by making use of external accountants, rather than by employing an accountant in-house.

Moreover, as Table 3.1 shows, the use of external accountants to prepare tax returns was fairly consistent between firm size groups, only varying between 56.1% of firms with between 5-9 employees to 58.3% of those with 1-4. However, significant variations can be identified between sectors (*χ2 sig. 0.05)*: highest in primary activities and in business services; as well as between legal status categories (*χ2* sig. 0.01). Limited companies, for example, were less likely to rely on external accountants to prepare their tax returns than partnerships or self-employed traders, because they were more likely to employ book-keepers and/or professional accountants themselves.

The use of external accountants to prepare, or assist with, tax returns also varied significantly with recent financial performance (i.e. during the last 12 months) (*χ2* sig. 0.001). Specifically, businesses that were loss making during the previous financial year were less likely to employ an external accountant to complete their tax returns than those that were profitable or broke even. Although no cause and effect relationship can be inferred, it would appear that the use of external accountants to help with tax returns was a more consistent feature of businesses with healthy financial performance.

3.3 Use of Electronic Methods of Paying Taxes

As Table 3.2 shows, in almost one quarter of responding enterprises (22.8%), one or more taxes are paid electronically. Not surprisingly perhaps, a statistically significant difference can be observed in the propensity to pay taxes electronically between (turnover) size groups, although there is not a consistent size gradient. In addition, non-VAT registered businesses are significantly less likely to pay at least one tax electronically than those that are VAT registered. Statistically significant differences can also be observed between sector groups: highest among firms in business services and manufacturing; lowest in construction.

Interestingly, however, it is not the case that some form of electronic tax payment is associated with the more successful firms, since loss-making businesses showed a considerably higher propensity to engage in this practice (30.8%) than either profitable firms (22.4%), or those in a breakeven situation in the financial year prior to the interviews[3].

[3] The difference between the financial performance categories is significant at the 0.059 level i.e. just below the conventional 0.05 cut-off.

Table 3.2

Source: SBRC HMRC Business Survey, 2005

Businesses Paying Taxes Electronically					
	VAT	**Corp. Tax**	**PAYE**	**Personal/NI**	**None**
Size	%	%	%	%	%
1-4	6.1	1.6	6.9	13.1	77.9
5-9	14.6	2.4	22.0	11.9	66.7
10-49	11.5	3.7	15.4	11.5	73.1
All	6.6	1.7	7.9	13.0	77.2
Turnover		**	***		**
Under £58,000	0.7	0.0	2.4	12.7	83.5
£58k-£149,999	8.1	1.8	8.1	11.7	76.6
£150k-249,999	13.6	4.3	13.6	15.8	68.3
£250k-£659,999	9.0	4.0	14.0	14.0	73.0
£660k+	12.5	0.0	5.0	15.0	77.5
All	6.8	1.8	7.6	13.2	77.2
VAT Registered* **	9.0	2.4	8.5	12.0	77.1
Legal Status	**	***	**		
Self employed sole trader	4.3	0.0	5.6	13.0	80.0
Partnership	5.0	0.0	5.7	20.7	72.1
Ltd company	10.9	4.9	12.2	9.5	75.9
All	6.8	1.7	7.9	13.1	77.2
Sector					
Primary	0.0	0.0	2.6	15.4	79.5
Manufacturing	5.8	2.9	10.1	20.3	72.1
Construction	2.8	2.2	7.2	11.1	82.2
Consumer Services	6.7	1.0	6.7	11.0	80.6
Business Services	10.3	1.8	9.9	14.3	71.3
All	6.6	1.6	7.9	13.0	77.3
Financial Performance in previous 12 months	*		***		
Made a profit	5.6	1.9	6.1	13.8	77.6
Made a loss	7.4	3.7	16.8	18.7	69.2
Broke even	11.7	0.0	6.3	7.8	82.0
All	6.8	1.9	7.6	13.5	77.2

*Notes: (i) *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

(ii) Size: n = 859 except Size by VAT (n = 858) and Size by Corporation tax (n = 860).
Turnover: n = 843 except Turnover by Corporation Tax (n = 845) and Turnover by PAYE (n = 844).
VAT Registered: n = 634 except VAT Registered by PAYE and VAT Registered by None (n = 633).
Legal Status: n = 858 except Legal Status by VAT (n = 859) and Legal status by none (n = 857).
Sector: n = 858 except Sector by VAT and Sector by Personal/NI (n = 859) and Sector by PAYE (n = 860).
Financial Performance: n = 806 except Financial Performance by Corporation Tax (n = 807).

When respondents were asked to explain the rationale for making on-line tax payments, by far the most common reason given was 'greater convenience' (by 63% of those making electronic tax payments; see Appendix 2; Q30). Other answers given included that: 'it saves time in making the payment (4.4%); and that 'it was cheaper' (3.8%).

As far as individual taxes are concerned, it is personal income tax/NI contributions, which are most commonly paid electronically (13.2% of those eligible to pay – see Appendix 2; Q29), followed by PAYE (17%) and VAT (9.1%). Only 11 firms reported paying Corporation Tax by electronic means, although this represents 6.5% of those eligible to do so (i.e. limited companies that reported profits during the previous 12 months). All were limited liability companies and were typically generating between £150,000 and £660,000 annual sales turnover.

The propensity to pay personal income tax/NI contributions electronically did not vary significantly between size and sector groups, although statistically significant variations can be identified on the basis of legal status and also on the basis of financial performance. With respect to legal status, it was partnerships where the propensity to use electronic payments for personal taxation was the highest and limited companies, where it was the lowest.

A statistically significant difference can be identified in the propensity of firms to use electronic payments for PAYE between turnover size groups, with this being a particular feature of firms with annual sales between £150,000 and £660,000. Both smaller and larger firms were much less likely to make electronic payments for PAYE, than firms in this size range. Electronic payment of PAYE was significantly more commonly reported by limited companies than by firms with other types of legal

form ($\chi 2$ sig. 0.01). As in the case of personal taxation/NI contributions, electronic payment of PAYE was also significantly more common in loss-making companies than in other firms ($\chi 2$ sig. 0.001).

Where respondents reported making VAT payments electronically, this was significantly more likely to be found in limited liability companies than in firms with other types of legal form ($\chi 2$ sig. 0.01), which mirrors the result with regard to electronic payment of PAYE. It also varied significantly between sector groups ($\chi 2$ sig. 0.001): highest in business services, on the one hand, but not reported at all by firms engaged in primary activities, on the other. Indeed, where firms engaged in primary activities were using electronic methods for tax payments at all, this was mainly for personal income tax/NI contributions. Once again, significant variations can be observed between financial performance categories, with profitable firms much less likely to use electronic payment methods for VAT than either loss makers, or those in a breakeven situation.

3.4 Financial Structure

Since it was hypothesised that one of the factors influencing the likelihood of firms experiencing cash flow problems, and thus the possibility that tax payments might impact on these, is the financial structure of enterprises, surveyed firms were asked if one or more of a list of specified sources of finance had been used during the previous two year period. The results show that 81.4% of respondents had used one or more of the specified sources. The most commonly reported sources of finance were bank overdrafts; personal savings; reinvested profits; bank loans; and leasing or hire purchase (see Table 3.3).

Table 3.3

Sources of Finance during the Previous Two Years	
Bank overdraft	47.4%
Personal savings	44.9%
Re-invested profits	36.9%
Bank loan	24.0%
Leasing/HP	22.6%
Loans from family/friends	12.2%
Equity from family/friends	11.2%
Government grant	3.3%
Factoring	1.7%
Venture capital/business angels	0.9%
None of these	18.6%
N	875

Source: SBRC HMRC Business Survey, 2005

Table 3.4

Main Source of Finance Used during the Previous 2 Years						
	Bank overdraft	**Re-invested profits**	**Personal savings**	**Bank loan**	**Leasing/HP**	**N**
Size ***	%	%	%	%	%	
1-4	32.5	21.1	21.3	8.9	6.3	653
5-9	30.6	22.2	13.9	11.1	8.3	36
10-49	45.5	22.7	4.5	9.1	9.1	22
All	32.8	21.2	20.4	9.0	6.5	711
Turnover **						
Under £58,000	29.8	12.7	30.7	7.5	7.0	228
£58k-£149,999	33.6	24.0	17.5	10.5	7.9	229
£150k-249,999	27.6	23.6	17.3	11.8	5.5	127
£250k-£659,999	42.3	30.8	9.0	6.4	5.1	78
£660k +	36.1	22.2	16.7	11.1	2.8	36
All	32.4	20.9	20.8	9.3	6.6	698
VAT Registered **	35.5	23.0	16.8	9.3	6.2	549
Legal Status						
Self employed sole trader	32.2	18.6	22.6	11.0	6.7	345
Partnership	33.9	23.7	20.3	7.6	4.2	118
Ltd company	33.1	23.8	18.1	6.9	7.3	248
All	32.8	21.1	20.7	9.0	6.5	711
Sector						
Primary	33.3	26.7	13.3	0	0	30
Manufacturing	45.3	13.2	17.0	15.1	1.9	53
Construction	39.7	12.1	22.7	5.7	11.3	141
Consumer Services	30.4	25.7	21.3	8.3	5.5	253
Business Services	27.8	23.2	20.3	11.4	6.8	237
All	32.6	21.3	20.6	9.0	6.6	714
Financial Performance ***						
Made a profit	29.5	24.9	17.8	9.3	7.7	454
Made a loss	48.5	16.5	19.6	6.2	0	97
Broke even	36.4	9.3	29.9	10.3	9.3	107
All	33.4	21.1	20.1	9.0	6.8	658

Source: SBRC HMRC Business Survey, 2005

Notes (i): $^{***}\chi^2$ significant at the 99.9% level; $^{**}\chi^2$ significant at the 99% level; $^{*}\chi^2$ significant at the 95% level

(ii) For the purpose of calculating x2, responses other than the five main sources listed in the above table were grouped into a single 'other' category, which represented 8.9% of the total responses.

When respondents, who had used one or more of the specified sources, were asked to identify the main source of finance during this period, the pattern of response was broadly similar, although the absolute level was lower (see Table 3.4). Bank overdrafts were the most commonly mentioned single main source, although if loans and overdrafts are combined, then 41.8% of respondents pointed to banks as their main source. Reinvested profits were the second most commonly mentioned main source, because although personal savings were more frequently drawn upon, they were less likely to be the main source of finance used than re-invested profits.

Table 3.4 shows that the use of bank overdrafts, which was the most commonly reported main source of finance, typically increased with increasing firm size, with significant differences identifiable between both employment and turnover size groups. Overdrafts were also more commonly used by firms in manufacturing and construction than by firms in other sectors. They were also significantly more likely to be used by loss-making firms than those with superior financial performance ($\chi 2$ sig. 0.001).

Reinvested profits had more consistently been used as a main source of funds across the firm size groups, although this was more common among limited liability companies and partnerships, than among sole proprietorships. Not surprisingly perhaps, their use was markedly higher among profitable firms than others, since a firm must first generate profits before they can be reinvested. However, the fact that reinvested profits were more commonly mentioned as the main source of finance by loss-making firms than those breaking even, suggest that in some cases re-investment is reducing the reported level of current profitability.

The use of personal savings was a particular feature of the smallest companies, employing less than five persons, and also operating below the VAT threshold. It was

more common in the construction and services sectors than in manufacturing or primary activities.

Although only 6.5% of respondents reported using leasing or hire purchase as their main source of finance, firms that used it were all either profitable or in a breakeven situation; and were typically in the construction, business services or consumer services sectors, rather than in manufacturing or primary activities (Table 3.4).

3.5 Business Performance

Another set of hypothesised influences on the propensity of small business owners to report negative impacts of taxation on cash flow are related to business performance. In this regard, respondents were asked to assess firstly, the trend in sales turnover during the previous financial year (after allowing for inflation); secondly, whether or not the business was profitable during this period; and thirdly, how the level of profitability compared with the previous year (after allowing for inflation) (see Table 3.5).

Table 3.5

Trend in Sales Turnover in the Last Financial Year				
	Increase	**Decrease**	**Stay the Same**	**All**
Size	%	%	%	
1-4	40.4	26.2	33.5	738
5-9	47.4	31.6	21.1	38
10-49	60.0	20.0	20.0	25
All	41.3	26.2	32.5	801
Turnover *				
Under £58,000	34.1	32.6	33.3	270
£58k-£149,999	40.6	23.1	36.3	251
£150k-249,999	45.5	20.1	34.3	134
£250k-£659,999	51.5	26.3	22.2	99
£660k-£1.5m	46.3	29.3	24.4	41
All	40.9	26.5	32.6	795
Registered for VAT	43.5	25.0	31.5	596
Legal Status				
Self employed sole trader	37.2	27.9	34.8	376
Partnership	51.1	22.3	26.6	139
Ltd company	42.0	25.5	32.5	286
All	41.3	26.1	32.6	801
Sector * **				
Primary	29.3	19.5	51.2	41
Manufacturing	40.9	36.4	22.7	66
Construction	34.1	22.6	43.3	164
Consumer Services	41.5	28.7	29.8	275
Business Services	47.8	23.9	28.2	255
All	41.3	26.1	32.6	801

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

The results presented in Table 3.5 show that in 41% of responding firms, sales turnover was reported to have increased during the previous 12 months; in approximately one third it was about the same; whilst in just over a quarter it actually declined. The propensity to report increased sales was positively related to firm size, at least up to firms with annual sales of £659,999. A statistically significant difference in sales turnover trends can also be identified between sector groups, with firms in business services showing the strongest overall sales trends and those engaged in

primary activities the weakest. Manufacturing firms were very polarised in this regard, since 41% increased their sales over the 12 month period, while 36% experienced a decrease.

Respondents were also asked if their firms had been profitable during the previous 12 months. As Table 3.6 shows, a majority of firms (70.4%) were reported to be profitable during this period, with the rest divided between those reporting losses and those in a breakeven situation. Significant differences can be observed in the propensity of firms to report profitability in terms of turnover size groups ($\chi 2$ sig. 0.01); legal status ($\chi 2$ sig. 0.001); and sector ($\chi 2$ sig. 0.001). These results suggest that firms most likely to be profitable during this period generated sales of more than £250,000; were partnerships or sole proprietorships; and were in the business services or consumer services sectors. By contrast, firms showing the highest propensity to report losses were limited liability companies; and engaged in primary or manufacturing activities.

Table 3.6

Profitability During Last 12 months				
	Made a Profit	**Made a Loss**	**Break Even**	**All**
Size	%	%	%	%
1-4	70.0	13.8	16.3	756
5-9	74.4	15.4	10.3	39
10-49	76.0	12.0	12.0	25
All	70.4	13.8	15.9	820
Turnover *				
Under £58,000	64.4	16.9	18.6	295
£58k-£149,999	72.8	8.9	18.3	257
£150k-249,999	70.0	13.1	16.9	130
£250k-£659,999	78.8	18.2	3.0	99
£660k-£1.5m	79.5	10.3	10.3	39
All	70.4	13.7	16.0	820
Registered for VAT	71.5	12.5	16.0	599
Legal Status				
Self employed sole trader	73.9	8.5	17.6	398
Partnership	81.3	10.1	8.6	139
Ltd company	60.1	22.6	17.3	283
All	70.4	13.7	16.0	820
Sector				
Primary	65.9	24.4	9.8	41
Manufacturing	50.7	23.2	26.1	69
Construction	68.8	9.1	22.2	176
Consumer Services	72.9	15.0	12.1	273
Business Services	74.8	11.5	13.7	262
All	70.4	13.8	15.8	821

Source: SBRC HMRC Business Survey, 2005

Note: $^{***}\chi^2$ significant at the 99.9% level; $^{**}\chi^2$ significant at the 99% level; $^{*}\chi^2$ significant at the 95% level

Respondents were also asked about their expectations with respect to sales turnover trends during the 12 months following the interviews. As Table 3.7 shows, less than half the responding firms (42.6%) were optimistic about turnover increasing during this period; 38.9% predicted a similar level of sales; and 15.9% sales reduction. Significant variations can be observed between turnover size groups, although the pattern is not consistent, particularly at the upper end of the size range. Businesses

generating more than £660,000 of annual sales were polarised, with a quarter predicting sales decline on the one hand, with 42% predicting sales growth (including 7.5% predicting substantial growth), on the other. In terms of sectors, it was respondents from firms in manufacturing and business services, which appeared the most optimistic about future sales growth, with those engaged in primary activities the most pessimistic.

Table 3.7

Respondents Expectations with Respect to Sales Turnover During the Next 12 Months						
	Grow Turnover Substantially (by 50% +)	**Grow Turnover Moderately (Up to 50%)**	**Keep the same Turnover**	**Reduce Turnover**	**Close the Business/ Retire**	**All**
Size	%	%	%	%	%	
1-4	5.4	36.8	39.0	16.0	2.8	782
5-9	5.1	41.0	35.9	17.9	0.0	39
10-49	7.7	42.3	38.5	11.5	0.0	26
All	5.4	37.2	38.8	15.9	2.6	847
Turnover						
Under £58,000	6.8	32.9	43.1	12.9	4.4	295
£58k-£149,999	5.2	40.5	34.9	16.0	3.3	269
£150k-249,999	5.9	33.8	39.0	21.3	0.0	136
£250k-£659,999	1.1	42.1	41.1	15.8	0.0	95
£660k-£1.5m	7.5	35.0	32.5	25.0	0.0	40
All	5.5	36.6	39.0	16.2	2.6	835
Registered for VAT	4.6	37.5	37.6	17.8	2.5	611
Legal Status						
Self employed sole trader	5.2	38.0	38.2	14.7	3.8	421
Partnership	4.9	34.3	46.2	13.3	1.4	143
Ltd company	6.0	37.1	36.0	19.1	1.8	283
All	5.4	37.1	38.8	15.9	2.7	847
Sector						
Primary	0.0	29.3	46.3	24.4	0.0	41
Manufacturing	4.5	46.3	38.8	4.5	6.0	67
Construction	4.8	31.1	43.1	18.6	2.4	167
Consumer Services	3.1	35.4	41.5	16.7	3.4	294
Business Services	9.7	41.2	32.3	15.1	1.8	279
All	5.5	37.0	38.8	15.9	2.7	848

Source: SBRC HMRC Business Survey, 2005

3.6 Summary

3.5.1 Use of Accountants

- A majority of small firms make some use of professionally qualified accountants to complete their tax returns (89%[4]), although this is typically by using external accountants, rather than by employing an accountant in-house.

- Referring specifically to the use of external accountants to complete tax returns, businesses that had made losses in the previous financial year were less likely to have employed an external accountant, than those that were either profitable or broke even.

3.5.2 Use of Electronic Methods to Pay Taxes

- It is not the case that some form of electronic tax payment is associated with the more successful firms, since loss-making businesses showed a considerably higher propensity to engage in this practice than either profitable firms, or those in a breakeven situation.

As far as individual taxes are concerned, it is personal income tax/NI contributions, which are most commonly paid electronically, followed by PAYE and VAT.

3.5.3 Financial Structure

- The most commonly reported sources of finance were bank overdrafts; personal savings; reinvested profits; bank loans; leasing or hire purchase.

- The use of bank overdrafts as the main source of finance typically increased with increasing firm size; it was more common in manufacturing and

[4] 58.2% of respondents reported using an external accountant to complete their tax returns and a further 27.2% used some external professional help. When those employing accountants internally are taken into account but which did not use external professional assistance (i.e. 3.4%), just 11.4% of firms completed tax returns without professional help.

construction than in other sectors; and overdrafts were significantly more likely to be used by loss-making firms that those with superior financial performance.

- Reinvested profits were consistently used as one of the main sources of finance across the firm size groups, although more commonly in limited liability companies and partnerships, than in sole proprietorships. Not surprisingly, their use was markedly higher among profitable firms than others.

- The use of personal savings as the main source of finance was a particular feature of the smallest companies, employing less than five persons; those operating below the VAT threshold; and more common in the construction and services sectors than in manufacturing or primary activities.

- Although only 6.5% of respondents reported using leasing or hire purchase as their main source of finance, firms that used it were all either profitable or in a breakeven situation.

3.5.4 Business Performance

- In 41% of firms, sales were reported to have increased during the previous 12 months; in about one third they were about the same; whilst in just over a quarter they declined. Significant differences in sales trends can be identified between size and sector groups.

- Seven out of 10 firms were reported to be profitable during the previous 12 months, with the rest divided between those reporting losses and those in a breakeven situation. Significant differences can be observed in the propensity

of firms to report profitability in terms of turnover size groups; legal status; and sector groups.

- Less than half the responding firms were optimistic about turnover increasing during the next 12 months; 39% predicted a similar level of sales; but 16% predicted a reduction in sales.

Chapter Four: Cash Flow Issues in Small Firms

4.1 Introduction

This Chapter examines the inflows and outflows of cash to the surveyed businesses and the particular problems faced by businesses in the process. The Chapter contributes to providing an analysis of the financial context within which the businesses have to operate when faced with the payment of taxation. It is anticipated that financially constrained businesses will have greater difficulty meeting taxation payment deadlines; conversely, more liquid businesses will find it easier to meet their tax payment obligations. This will involve an examination of a number of factors and how these relate to the effect of the timing of taxation payments. This Chapter specifically seeks to examine:

i. The methods of payments and receipts in firms, including the use of credit, cash, and invoice payments and receipts

ii. The extent of late payment and bad debt

iii. The relative importance of different sources of cash flow problems for the business

Overall, the Chapter will provide an important context for the analysis of the impact of the timing of tax payments. It is within these conditions that firms have to operate when making their taxation payments.

4.2 Business Purchases and Sales

A basic issue for most businesses is 'getting the money in'[5] and paying suppliers and other bills. This was confirmed as a major task for business owners in all stages of the data collection. *A priori*, it was expected that the actual form of payments and receipts (i.e. cash or invoices) are important factors when examining the ability of businesses to pay taxes on time. Delayed receipt of sales income, or expenditure on supplies received, can affect the cash flow of businesses.

The survey revealed a variety of ways of 'doing business' ranging from 'cash based businesses' to those using invoices and credit based methods. The majority of businesses used a mixture of cash, credit and invoices for the purchases (60.4%) although 21.5% did not use cash at all (Table 4.1). Cash sales were more important than cash purchases for the surveyed business owners.

Table 4.1

Purchases and Sales in the Businesses		
	Purchases %	**Sales %**
All cash	15.2	24.4
Some Credit or Invoices	60.4	38.2
All Credit or Invoices	21.5	24.7
No Data	3.0	2.7
All	**100.0**	**100.0**
Weighted N	875	875
Median invoices or credit	85.0	70.0
Mean % invoices or credit	65.2	54.7

Source: SBRC HMRC Business Survey, 2005

In other words, smaller firms tended to receive a higher proportion of their income in cash than they paid out for supplies. Although the reasons for this difference between purchases and sales are not immediately apparent, it does suggest that small firms are more likely to work in cash and this may be a result of a combination

[5] This emerged as a key issue in the focus group and is a quote from one of the participants.

of the 'need to get the money in' and the norms of payment for suppliers. This is an important finding since the form of income and outgoings may affect the ability to pay taxes on time.

4.3 Causes of Cash Flow Difficulties

One of the key contextual factors in assessing the impact of the timing of tax payments on small firms is the management of cash flow. Business owner-managers were asked which, if any, of a number of difficulties had caused, or contributed to, cash flow difficulties during the past year and the main difficulty (Table 4.2).

Table 4.2

Cause of Cash Flow Difficulties in Past Year		
	All Difficulty	**Main Difficulty**
Either income or outgoings tend to fluctuate	51.1	20.4
Having to pay all of a particular tax in one lump sum	46.3	13.3
Having to make tax payments at a specific time	42.9	9.6
Late payment by customers (incl bad debts)	38.2	31.3
Having to make several tax payments at the same time	33.6	4.4
High levels of working capital needed	28.8	4.2
Paying penalties incurred by late payment of tax	19.3	1.2
High levels of capital investment in the business	18.1	2.8
Lack of cash flow planning by the business	17.9	2.2
Early payment required by suppliers	17.6	1.9
Fear of losing customers by chasing debt	16.7	0.1
Difficult or expensive to get credit from suppliers	9.6	1.7
Unforeseen circumstances	0.8	0
VAT too expensive	0.6	0
Other reason	3.7	2.6
Other – tax-related reason	-	1.9
None of the above reasons	22.8	N/A
No data	0	2.4
Weighted N	**875**	**553**
Notes: First response column is multi-response; hence percentages do not sum to 100.		

Source: SBRC HMRC Business Survey, 2005

A key issue affecting cash flow difficulties is the fluctuations in income and outgoings:

51.1% of firms reported this as a problem and 20.4% reported this as the main difficulty. Late payment by customers was also important across the sample and the highest recorded main difficulty (Table 4.2).

The payment of taxes was perceived as a contributory cause of cash flow difficulties for a sizeable number of business owners. Having to pay taxes in a lump sum (reported by 46.3% of the sample), paying on a specific time (42.9%), having to make several payment at the same time (33.6%) and paying penalties incurred for late tax payments (19.3%) were all reported.

The importance of tax payment issues drops significantly when the main difficulties are examined. Here the main difficulty related to taxation is paying a lump sum (13.3%), followed by making tax payments at a specific time (9.6%). Combined, however, taxation issues account for one in three (29.2%) of all of the main causes of cash flow difficulties reported in the past year.

Cash flow problems were not endemic in the sample. However, for some businesses cash flow problems were considered to be a more or less permanent state of affairs (16.7% of whole sample) or 'fairly frequent but not permanent' (16.9%).[6] On the other hand, 41.6% (see Appendix 2; Q9) stated that cash flow difficulties were quite rare and unusual. There was some expectation that cash flow difficulties would be associated with different context and performance characteristics of the business.

[6] These figures relate to the whole sample and are reported in Appendix 2. When cross-tabulations are made with these key variables the percentages vary slightly because of different base numbers.

Table 4.3

Business Context: Would you say that cash flow problems are…					
	More or less permanent state of affairs	**Fairly frequent, but not permanent**	**Occasional**	**Quite rare**	**All**
Size	%	%	%	%	
1-4	16.3	16.8	24.2	42.7	803
5-9	23.8	21.4	26.2	28.6	42
10-49	23.1	15.4	23.1	38.5	26
All	16.9	17.0	24.2	41.9	871
Turnover ***					
Under £58,000	9.8	14.8	24.3	51.1	305
£58k-£149,999	19.0	16.8	27.7	36.5	274
£150k-249,999	31.4	20.7	15.7	32.1	140
£250k-£659,999	13.3	16.3	25.5	30.0	40
£660k-£1.5m	15.0	25.0	30.0	30.0	40
All	16.9	17.0	24.4	41.7	857
Registered for VAT ***	18.4	18.3	26.2	37.1	630
Legal Status **					
Self employed sole trader	16.4	15.7	27.8	40.1	421
Partnership	13.2	15.3	16.7	54.9	144
Ltd company	19.1	19.8	23.1	38.0	303
All	16.8	17.1	24.3	41.8	868
Sector					
Primary	14.6	9.8	24.4	51.2	41
Manufacturing	17.4	27.5	21.7	33.3	69
Construction	13.9	15.6	26.7	43.9	180
Consumer Services	19.1	17.1	24.8	38.9	298
Business Services	16.3	16.3	23.0	44.3	282
All	16.8	17.0	24.4	41.8	870

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

Table 4.3 shows that businesses in the £150-249k turnover size band, having limited liability and in consumer services were more likely to report cash flow problems as a more or less permanent state of affairs (χ^2 *0.000*). The relationships are not precisely linear, however, which suggests that other influences are also at work. Conversely, it appeared to be smaller firms in terms of both employment and turnover, partnerships and in the primary sectors that were more likely to report cash flow problems as 'rare'.

Table 4.4

Would you say that cash flow problems are…					
	More or less permanent state of affairs %	**Fairly frequent, but not permanent %**	**Occasional %**	**Quite rare %**	**All**
Cash sales ***					
None	13.2	14.9	28.1	43.9	303
Some	21.9	20.1	24.9	33.1	329
100%	13.5	16.3	19.5	50.7	215
All	**16.6**	**17.2**	**24.7**	**41.4**	**847**
Sales predictability ***					
No variation	11.0	11.0	20.1	57.9	254
Variable but predictable	13.8	14.3	34.0	37.9	203
Variable and unpredictable	22.2	22.2	21.3	34.2	409
All	**17.0**	**17.1**	**23.9**	**42.0**	**866**
Turnover previous 12 months ***					
Increase	17.5	10.6	31.1	40.8	331
Decrease	17.6	19.6	20.6	42.2	204
Stay the same	11.5	20.6	21.0	46.9	262
All	15.6	16.2	25.1	43.2	797
Profits 12 months ***					
Made a profit	11.1	15.1	27.1	46.6	575
Made a loss	30.0	30.9	12.7	26.4	110
Broke even	21.4	13.7	28.2	36.6	131
All	15.3	17.0	25.4	42.3	816
Profit performance previous year ***					
Better	12.1	11.2	28.6	48.1	322
Worse	19.7	25.6	20.7	34.0	203
The same	15.5	13.4	26.9	44.1	238
All	15.2	15.7	26.0	43.1	763
Employment Growth					
Growing	17.6	18.3	18.3	45.8	142
Stable	16.0	15.6	26.5	41.9	601
Shrinking	19.8	23.0	20.6	36.5	126
All	16.8	17.1	24.3	41.8	869

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

An analysis of the cash sales of the businesses shown in Table 4.4 reveals a mixed pattern in the relationship with cash-flow problems. However, businesses undergoing conditions of variable and unpredictable sales are more likely to experience cash flow problems (χ^2 0.000). There are also strong statistically significant relationships with the performance of turnover and profits in the past 12 months. Making a loss or decline in profits over the past 12 months was strongly associated with having cash flow problems. The relationship with turnover change is complex: although those experiencing a decrease in turnover and profits reported 'permanent' cash flow problems, those experiencing turnover growth also had high percentages recording 'permanent' cash flow problems. This was probably for different reasons: those suffering from a loss of income and experiencing difficult trading conditions would simply have difficulty raising funds to pay a tax demand whilst those that were expanding were possibly looking to use their income for investment.

4.4 Late Payment

Combined late payment and bad debt emerged as the main cause of cash flow difficulties in the sample (31.3%: see Table 4.2). If we break this down further, late payment was reported by 13.1% of businesses as a critical problem and 19.5% as a major problem in the sample (See Appendix 2; Q6). This reflects the general view that late payment is an issue for businesses with specific characteristics rather than across the whole population of firms. The survey shows that it is business in the mid-sized firms in the sample (turnover £150 - £249,999) and those in Manufacturing that report the highest incidence of late payment as a critical problem (χ^2 0.000) (Table 4.5)

Table 4.5

Business Context: Would you describe late payment as…					
	A Critical problem	**A Major Problem**	**A Minor problem**	**Not at all a problem**	**All**
Size	%	%	%	%	
1-4	13.1	19.1	32.0	35.7	596
5-9	17.1	25.7	40.0	17.1	35
10-49	18.2	27.3	40.9	13.6	22
All	13.5	19.8	32.8	34.0	653
Turnover ***					
Under £58,000	12.2	16.6	31.7	39.5	205
£58k-£149,999	10.5	21.0	36.2	32.4	210
£150k-249,999	28.6	13.4	33.0	25.0	112
£250k-£659,999	6.6	31.6	32.9	28.9	76
£660k-£1.5m	5.9	20.6	32.4	41.2	34
All	13.5	19.5	33.6	33.4	637
VAT Registered ***	11.4	22.7	35.5	30.3	498
Legal Status *					
Self employed sole trader	13.8	16.8	28.6	40.7	297
Partnership	9.3	26.8	37.1	26.8	97
Ltd company	14.0	20.6	36.2	29.2	257
All	13.2	19.8	32.9	34.1	651
Sector ***					
Primary	7.4	14.8	37.0	40.7	27
Manufacturing	27.1	18.6	22.0	32.2	59
Construction	16.8	21.5	30.2	31.5	149
Consumer Services	11.5	9.8	42.6	36.1	183
Business Services	9.8	27.2	29.4	33.6	235
All	13.3	19.8	32.9	34.0	653

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

If we turn to business processes and performance (Table 4.6) it appears to be those firms that are undergoing permanent cash flow problems (χ^2 0.000), with variable sales income (χ^2 0.003) or have expanded in turnover and declined in profit (χ^2 0.000), that are more likely to record late payment as a critical problem.

Table 4.6

Business Processes and Performance: Would you describe late payment as …					
	A Critical Problem %	**A Major Problem %**	**A Minor Problem %**	**Not at all a problem %**	**All**
Cash flow problems ***					
Permanent	28.8	31.4	16.1	23.7	118
Frequent	27.4	32.7	22.1	17.7	113
Occasional or rare	5.3	12.7	40.9	41.1	416
All	**13.4**	**19.6**	**33.1**	**33.8**	**647**
Sales Predictability **					
No sales variation	6.3	19.4	37.7	36.6	175
Variable but predictable	12.8	14.7	32.1	40.4	156
Variable and unpredictable	17.2	22.9	30.1	29.8	319
All	**13.2**	**20.0**	**32.6**	**34.2**	**650**
Turnover previous 12 months					
Increase	13.3	20.1	37.5	29.2	264
Decrease	11.1	16.3	28.1	44.4	153
Stay the same	11.5	20.3	33.0	35.2	182
All	12.2	19.2	33.7	34.9	599
Profits 12 months ***	%	%	%	%	%
Made a profit	10.7	18.7	34.0	36.5	438
Made a loss	27.8	16.5	25.3	30.4	79
Broke even	14.1	29.3	33.3	23.2	99
All	13.5	20.1	32.8	33.6	616
Profit performance previous year *					
Better	11.3	16.0	38.3	34.4	256
Worse	16.4	14.5	30.8	38.4	159
The same	9.9	24.8	27.3	37.9	161
All	71	104	191	210	576
Employment Growth					
Growing	12.2	26.1	34.8	27.0	115
Stable	13.1	19.5	33.5	33.9	442
Shrinking	14.7	13.7	27.4	44.2	95
All	13.2	19.8	32.8	34.2	652

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

Late payment by clients is a common occurrence, although this does not necessarily lead to major cash flow problems for businesses. In part, this depends on precisely how late payment is handled. Where businesses are proactive in managing client payment, the likelihood of major cash flow problems can be reduced. Managing client payment includes ensuring invoices are sent out as soon as is practical, using stage payments where work done for clients takes place over the long-term, and then chasing payment where clients exceed agreed credit terms.

> "My biggest non-profit priority … is getting the bills out and chasing all the time. We've altered the terms of business, from 28, 30 days. Now we take 14 days, assuming that people won't pay us till thirty. But we've found that if you do say thirty days they keep it sixty or ninety!" (JK5: planning consultancy, 5 workers)

> "… It's quite regularly an issue. Graham's [Office Manager] quite good at keeping on top of it but it's something that needs to be watched. We have to employ a person especially to chase, credit control … He comes in three days a week and probably spends two of those days chasing payment … It used to be an issue or occasionally you'll lose one credit controller and it'll creep up. Or you might employ somebody who after a while you realise they're not doing such a good job and the debt will creep up. So, it's not an issue for us at the moment, because Brian who does the work is quite good and keeps on top of it and has a system. It's better than it was because we quote up front. But it could easily become quite a big problem for us if we weren't on top of it, simply because other businesses take the view that we do – that, until we're chased, we don't pay. And that seems to be the common thing now." (JK4: accountancy practice, 22 workers)

Whether late payment by clients actually becomes a serious cash flow problem depends on the financial position of the business. Where businesses have substantial cash resources, whether in the form of a bank account, an overdraft facility, or even access to resources from family and friends, then business owners may be able to avoid major cash flow difficulties. The following business owner, a self-employed consultant working from home, explained her 'lucky' situation in terms of being able to rely on her partner's income should her own business fall on hard times.

> "It's become a bad problem where, yes, I need the money. But, again, that kind of gets back to my very lucky personal situation. If I was on my own and was having to pay a mortgage or rent as well, it would be difficult. I would have had to set it up different. I wouldn't have the luxury of having a 'finding my feet' period. I would have had to set it up before I left [my previous job]. I knew there was work out there but I did have the luxury of finding my feet ..." (JK7: PR consultant, 1 worker)

4.5 Bad Debt

Bad debt appears to be less widespread across the sample than late payment. Around 41.6% (see Appendix 2; Q7) of the sample said that they had written of 'some' sales turnover as bad debt. Of these, 10.8%, stated that it had caused a critical problem for the business and 20.8% a major problem. Although bad debt was less of a widespread experience in the sample than late payment, nevertheless it appeared to be affecting some businesses adversely and this will undoubtedly impinge on their cash flow, with the possible consequence of affecting their ability to pay a tax demand. Table 4.7 shows that it tends to be the smaller businesses that are more likely report bad debt as a critical problem. Self employed sole traders report high levels of difficulty, although they are also likely to report high levels of not at all a problem ($\chi^2$0.000).

Table 4.7

Business Context: Would you describe bad debt as…					
	A Critical Problem	**A Major problem**	**A Minor problem**	**Not at all a problem**	**All**
Size	%	%	%	%	
1-4	11.4	21.3	42.5	24.8	254
5-9	9.5	19.0	57.1	14.3	21
10-49	7.1	14.3	57.1	21.4	14
All	11.1	20.8	44.3	23.9	289
Turnover					
Under £58,000	20.5	18.2	31.8	29.5	88
£58k-£149,999	7.5	14.0	58.1	20.4	93
£150k-249,999	6.0	38.0	30.0	26.0	50
£250k-£659,999	11.8	26.5	47.1	14.7	34
£660k-£1.5m	5.0	10.0	65.0	20.0	20
All	11.6	20.7	44.2	23.5	285
Registered for VAT ***	7.2	23.3	49.3	20.2	223
Legal Status ***					
Self employed sole trader	18.8	9.4	39.3	32.5	117
Partnership	6.1	26.5	51.0	16.3	49
Ltd company	5.0	29.8	47.1	18.2	121
All	10.8	20.9	44.6	23.7	287
Sector					
Primary	0.0	0.0	0.0	0.0	0
Manufacturing	11.8	26.5	44.1	17.6	34
Construction	6.5	38.7	41.9	12.9	62
Consumer Services	13.1	10.7	56.0	20.2	84
Business Services	11.2	16.8	38.3	33.6	107
All	10.8	20.9	44.9	23.3	287

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

Table 4.8

Business Processes and Performance: Would you describe bad debt as…					
	A Critical Problem %	**A Major Problem %**	**A Minor Problem %**	**Not at all a problem %**	**All**
Cash sales ***					
None	0.0	17.3	59.6	23.1	104
Some	18.0	22.7	38.4	20.9	172
All	**11.2**	**20.7**	**46.4**	**21.7**	**276**
Sales predictability ***					
No sales variation	2.9	16.2	50.0	30.9	68
Variable but predictable	24.3	15.7	45.7	14.3	70
Variable and unpredictable	8.1	25.5	41.6	24.8	149
All	**10.8**	**20.9**	**44.6**	**23.7**	**287**
Cash flow problems ***					
Permanent	23.4	26.6	35.9	14.1	64
Frequent	9.7	30.6	44.4	15.3	72
Occasional or rare	4.7	14.7	49.3	31.3	150
All	**10.1**	**21.3**	**45.1**	**23.4**	**286**
Turnover previous 12 months ***					
Increase	7.6	15.2	49.2	28.0	132
Decrease	20.3	16.9	42.4	20.3	59
Stay the same	5.8	36.0	38.4	19.8	86
All	27	61	123	66	277
Profits 12 months ***					
Made a profit	9.0	13.8	47.9	29.3	188
Made a loss	32.1	17.9	39.3	10.7	28
Broke even	9.3	50.0	31.5	9.3	54
All	11.5	21.5	43.7	23.3	270
Profit performance previous year *					
Better	12.9	12.9	51.5	22.8	101
Worse	8.2	32.8	42.6	16.4	61
The same	8.7	25.0	34.8	31.5	92
All	10.2	22.0	43.3	24.4	254
Employment Growth					
Growing	9.4	24.5	45.3	20.8	53
Stable	11.5	20.3	41.7	26.6	192
Shrinking	11.6	20.9	53.3	14.0	43
All	11.1	21.2	44.1	23.6	288

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

The relationship between bad debt and business performance is reported in Table 4.8. It is clear that there is a strong association between bad debt and sales turnover change in the past year: 20.3% of those reporting a decrease in sales also reported

bad debt as 'a critical problem' compared with only 7.6% who reported having sales increase ($\chi^2 0.001$.). Similarly, businesses that reported making a loss were also much more likely to report bad debt as a critical problem ($\chi^2 0.000$.). However, bad debt seemed to occur across the board in relation to type of sales income and sales predictability, with the exception that none of the businesses dealing in invoices (i.e. no cash sales) reported bad debt as a critical problem ($\chi^2 0.000$).

4.6 Coping With Cash Flow Difficulties

The reported responses by owner-managers to their businesses cash flow difficulties are broad (Table 4.9) - ranging from use of the bank overdraft (59.1%) to delayed payment to suppliers (39.2%) and tax payments not paid on time. The main coping strategies, however, are more concentrated and include using a bank overdraft (38.4%) or personal savings (18.9%). Avoiding paying taxes on time drops from 24% in the multiple response to 5.8% as the main effect. This is not surprising since there are be financial penalties linked to non – payment and it may, therefore, be regarded as a last resort.

Table 4.9

Have Your Cash Flow Difficulties Led To Any of the Following in the Past Year?		
	All	Main
Use of bank overdraft to cover cash flow need	59.1	38.4
Use of personal savings to cover cash flow needs	52.0	18.9
Took on a loan	21.9	6.4
Delayed payment to suppliers	39.2	16.0
Tax payments not made on time	24.0	5.8
Lower profit margin / higher costs	2.5	1.1
Use of business savings to cover cash flow needs	1.4	0
Limiting Business Growth	1.8	-
Inadequate funds for working capital	1.1	-
Turning down business as it is likely to entail cash flow problems	0.4	0
Staff Redundancies	1.2	-
Personal Distress	2.1	-
Bad relations with suppliers	1.2	-
Inadequate funds for investment	1.1	-
Can't pay him/herself	0	-
Other	2..2	8.0
Don't Know	0	5.4
None of these were consequences of cash flow difficulties	13.5	N/A
Weighted N	675	422
Unweighted N	719	451

Source: SBRC HMRC Business Survey, 2005

One possible response by owner-managers to late payment by customers could be the use of a statutory right to interest charges. The survey found that although 80.5% of businesses were aware of the statutory right to interest on late payment, only 9.5% of there had actually used this right (See Appendix 2: Q12). However, if we focus on those business reporting late payment as difficulty in the past year (Table 4.2: 38.2%) the percentage of businesses using the statutory right to interest

rises to an estimated 20% (67 firms using a statutory right from 334 stating that late payment had caused a cash flow problem in the past year). This implies that a significant proportion of businesses were prepared to use this right in this sample. Evidence from the face-to-face interview study suggests that many business owners were unwilling to use this right for two reasons. First, the interest rate that can be charged is low and would not generate substantial additional revenue. Second, some owners were reticent to exercise the right because of the potential risk to reputation and possible knock-on effects in terms of lost custom. Indeed research elsewhere suggests that some smaller firms were prepared to accept late payment as one of the ways in which they can mark themselves off from larger firms.

In cases of very severe cash flow difficulty, some business owners resort to meeting major outgoings using a personal credit card. As the following remarks make clear, where major payments need to be made – in this case, for VAT – and the business lacks access to the cash to meet them, business owners may need to fall back on personal resources.

> "It is a problem, yes, because sometimes I have to borrow from my personal credit card …. Two or three times it has happened that we go up to the limit of £25, 000 then some important bill like VAT or tax has to be paid and I can't go to the bank. They won't give you more than this. And so you have to find another way like using a credit card and put some money in which you can take out. It has happened two or three times in the last year; it hasn't happened before…" (JK6: restaurant, 12 workers)

> "It's a constant balancing problem. Sometimes you have to extend your overdraft on a temporary basis and other times you've got to put your hand in your pocket as the owner of a small business because there isn't an alternative and I know some people do put credit on credit cards … but that's really short term stuff because it's too expensive." (KB4: printer, 12 workers)

4.7 Summary and Conclusions

- This Chapter has analysed the importance of cash flow problems for small firms. A number of issues have emerged which are important in their own right but also provide an important background for the examination of the impact of the timing of tax payment on small firms.

- First, the incidence of cash flow problems is uneven across the sample: some businesses appear to suffer more than others. This unevenness is concentrated in businesses with particular characteristics and performances. However, there are no simple patterns and the influences are complex.

- Second, late payment by clients and customers is a major cause of cash flow problems. Obviously, where business owners encounter problems in 'getting the money in', this reduces the resources available to meet their working capital requirements. Cash flow problem lead employers to respond by delaying payments to suppliers, employees and (more reluctantly) the tax authorities. Clearly, this can have adverse, not to say disastrous consequences for businesses.

- Third, liability for tax payments is a major cash flow concern for many businesses. This is particularly so when taxes have to be paid in a one-off lump sum rather than in smaller, more frequent, instalments. This point highlights the reciprocal influence of client payment and tax payments. Where businesses are cash-poor, owners often have to make a choice between making tax payments and paying key suppliers.

- Fourth, business owners address cash flow difficulties in a variety of ways, but primarily by using a bank overdraft.

Chapter Five: Impact of Taxation on Cash Flow

5.1 Introduction

This Chapter examines the specific effects of the method and timing of tax payments on the cash flow of businesses. At the time they need to be paid, the payment of taxes can cause cash flow problems for small business owners. Alternatively, the requirement to pay taxes some time after liability for them has accrued might also be perceived as offering a cash flow benefit for business owners. Whether, and to what extent, these problems and benefits arise for small business owners is the subject of this chapter. It will set these effects within the framework of the business context, processes and performance. The analysis will cover the four main areas of taxation: VAT; PAYE and Employer NICs; Corporation Tax; and personal taxation and NICs. It will also examine the sources of funds to pay taxes.

5.2 Payment of VAT

5.2.1 Methods of Payment of VAT

Almost three-quarters of the businesses (72.5%) were registered for VAT. A number of VAT payment methods are currently available.[7] The conventional method is for businesses to submit VAT returns on the basis of customer invoices issued during a specific period, usually every three months. Other methods include the Cash Accounting Scheme which allows businesses to pay VAT *only* on cash received from customers, though they can only claim VAT when they have paid suppliers. This

[7] These figures relate to the whole sample and are reported in Appendix 2. When cross-tabulations are made with these key variables the percentages vary slightly because of different base numbers.

scheme gives automatic relief on the VAT element of late payments and bad debts. The Annual Accounting Scheme allows business owners to submit VAT in instalments during the year together with a final balancing payment, rather than every quarter. Both of these schemes are open to businesses with an annual turnover of less than £660,000. The Flat Rate Scheme allows businesses to calculate VAT they owe by applying a single percentage, based on sector, to turnover. In 2004-5, this scheme was open to businesses with an annual turnover of less than £150,000.

The dominant form of payment was 'VAT paid quarterly on invoices issued' (82.9%) (Table 5.1). There was however, a very low take up of the 'Annual Accounting' and 'Flat Rate' Schemes. Face-to-face interview evidence suggests that many of those using the conventional VAT payment method did so because they had done so for many years and/or because they were unaware of other methods.

Table 5.1

Payment Methods Used For VAT and Awareness of Methods		
	Used	**Heard of**
	%	% (weighted n)
VAT paid quarterly on invoices raised	82.9	65.5 (111)
Cash Accounting Scheme	15.0	36.3 (542)
Annual Accounting Scheme	4.7	43.9 (604)
Flat Rate Scheme	3.1	35.3 (617)
Retail Point of Sale Scheme	2.4	18.1 (619)
Retail Apportionment Scheme	0.4	11.9 (632)
Retail Direct Calculation Payment	0	9.2 (634)
Another method of payment	3.9	N/A
Don't Know	3.4	38.8 (634)
Note: 'used' column sums to more than 100% due to multiple choice.		

Source: SBRC HMRC Business Survey, 2005

The advantages of adopting the Annual Accounting Scheme are that it enables business owners to 'smooth out' cash flow effects because payments are 'little and often' rather than 'large and infrequent'. This was recognised by some business owner-managers:

> "It's smoothing out the cash flow, paying monthly rather than a big hit quarterly. So it helps a bit. And, also - it doesn't apply so much right at the moment – but we've found when our turnover was going up, that it helps your cash flow because you're paying less. So, in the current year, you're paying what they've assessed you on for the previous year effectively. Because what they do is they look at how much you paid last year and they assume you're going to pay the same this year. So, if your turnover's rising, you'll end up paying more VAT on the annual accounts than you pay based on the previous year. So you're actually paying monthly and you end up sort of slightly under-paying during the year and just have to make a slightly larger balancing payment at the end. So that helps your cash flow a bit…" (JK3: retailer, 5 employees)

Owner-managers appeared to have an uneven awareness of VAT payment methods. Hence, whilst almost two-thirds (65.5%) of respondents *not* using the 'Quarterly Invoice' method of payment were aware of this, only a third (36.3%) *not* using the 'Cash Accounting Scheme' were aware of this method. High levels of awareness did not, however, necessarily lead to high levels of take-up: for example, whilst only 4.7% used the 'Annual Accounting Scheme' 43.9% of those not using it were aware of this method, although some of these may not be eligible.

The reasons for choosing the method of payment varied (Table 5.2) although were dominated by 'usual method' (31.7%), followed by 'convenience' (18.8%) and 'accountant recommended it' (10.2%). The findings suggest a certain amount of inertia in the payment method used and also highlight the importance of accountants as advisers.

Table 5.2

Reasons for Using VAT Payment Methods		
	Main %	Other %
*Usual method	31.7	1.0
*Convenience/ease/simplicity	18.8	5.8
Your accountant recommended this	10.2	2.1
Not aware of any other method	7.8	2.3
*Suits business needs	7.6	4.1
*Default method offered to respondent	4.8	1.1
Easier to make payments in smaller instalments than in larger amounts	3.6	2.2
*To use cash accounting method i.e. pay VAT only on cash received	2.8	1.5
*Improves cash flow	1.9	3.3
Easier to calculate VAT payments	1.3	0.8
*Makes managing finances easier	1.2	0.4
*VAT office recommendation	0.9	0.7
Saves time	0.4	0.4
Allows a longer delay between collection of VAT and payment of VAT	0.4	0.4
Ensures predictability of VAT payments	0	0.8
Allows VAT to be collected before payments need to be made	0	0.4
Any other reason for using the method you do	0.1	1.4
Don't Know	0.1	0
No particular reason	6.1	76.5
Weighted N	634	634
Unweighted N	750	750
Notes: new categories added (*) following post-coding of initial 'other' responses.		

Source: SBRC HMRC Business Survey, 2005

5.2.2 Paying VAT: Effects of the Timing of the Payment

Paying VAT presented a 'critical' or 'major' cash flow problem for 17.8% of the sample paying VAT and was 'no problem at all' or 'a minor cash flow problem' for 80.7% (Appendix 2; Q16).

Table 5.3

Business Context: When it comes time to pay VAT does this cause, or contribute to …					
	A Critical Cash flow problem	**A Major Cash flow problem**	**A Minor Cash flow problem**	**No problem at all**	**All**
Size	%	%	%	%	
1-4	5.9	11.4	38.5	44.2	563
5-9	7.9	18.4	39.5	34.2	38
10-49	4.3	17.4	39.1	39.1	23
All	5.9	12.0	38.6	43.4	624
Turnover *					
Under £58,000	3.7	15.0	45.8	35.5	107
£58k-£149,999	5.8	8.6	38.3	47.3	243
£150k-249,999	12.8	13.5	36.1	37.6	133
£250k-£659,999	1.1	15.8	35.8	47.4	95
£660k-£1.5m	2.6	13.2	44.7	39.5	38
All	6.0	12.2	39.1	42.7	616
Registered for VAT	5.9	12.0	38.6	43.4	624
Legal Status *					
Self employed Sole trader	4.7	18.1	36.6	40.5	232
Partnership	7.3	6.5	35.8	50.4	123
Ltd company	6.0	9.0	41.9	43.1	267
All	5.8	11.9	38.7	43.6	622
Sector ***					
Primary	0.0	0.0	6.5	93.5	31
Manufacturing	7.4	22.2	27.8	42.6	54
Construction	7.0	11.3	49.6	32.2	115
Consumer Services	5.9	11.9	40.7	41.5	236
Business Services	5.3	11.7	38.3	44.7	188
All	5.8	12.0	38.8	43.4	624

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

Table 5.3 shows the relationship between business characteristics and the extent of the problem the timing of VAT payments creates. In relation to business context factors there are few exceptions to the general pattern that the payment of VAT does *not* generate a critical cash flow problem. However, businesses in Manufacturing and Construction were more likely to state that the timing of VAT payments was a critical cash flow problem.

Table 5.4

Processes and Performance: When it comes time to pay VAT does this cause, or contribute to …					
	A Critical Cash flow problem	**A Major Cash flow problem**	**A Minor Cash flow problem**	**No problem at all**	**All**
Cash sales ***					
None	1.8	11.7	37.8	48.6	222
Some	11.2	11.2	40.8	36.8	250
100%	2.2	15.3	35.8	46.7	137
All	**5.7**	**12.3**	**38.6**	**43.3**	**609**
Cash Flow Problem ***					
Permanent	16.2	20.5	37.6	25.6	117
Frequent	9.6	23.5	51.3	15.7	115
Occasional or rare	1.8	6.1	35.2	56.9	392
All	**5.9**	**12.0**	**38.6**	**43.4**	**624**
Sales predictability ***					
No variation	2,2	6.6	38.5	52.7	182
Variable but predictable	7.1	11.3	34.8	46.8	141
Variable and unpredictable	7.8	15.9	40.7	35.6	295
All	**6.0**	**12.1**	**38.7**	**43.2**	**618**
Turnover previous 12 months					
Increase	6.6	12.5	39.3	41.6	257
Decrease	6.3	12.5	39.6	41.7	144
Stay the same	4.8	11.7	38.8	44.7	188
All	5.9	12.2	39.2	42.6	589
Profits 12 months ***					
Made a profit	4.0	8.3	41.5	46.2	422
Made a loss	6.7	25.3	26.7	41.3	75
Broke even	10.3	16.5	42.3	30.9	97
All	5.4	11.8	39.7	43.1	594
Profit performance previous year ***					
Better	3.4	7.7	36.9	51.9	233
Worse	7.7	19.2	39.7	33.3	156
The same	4.6	11.4	45.1	38.9	175
All	5.0	12.1	40.2	42.7	564
Employment Growth ***					
Growing	7.6	6.7	32.4	53.3	105
Stable	5.2	11.2	43.8	39.8	420
Shrinking	7.2	20.6	22.7	49.5	97
All	5.9	11.9	38.6	43.6	622

Source: HMRC Business Survey, 2005

Note: Cash Sales includes non responses in all figures (n=14)
**** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

What of the relationship between business processes and performance and the effects on cash flow of the payment of VAT? Table 5.4 shows that firms experiencing 'more or less permanent' cash flow problems were much more likely to report the timing of VAT as causing a critical cash flow problem than where businesses

experienced 'frequent' or 'occasional or rare' cash flow problems (χ^2 *0.000*). Businesses with no cash sales were marginally less likely to report critical cash flow problems when paying VAT (χ^2 *0.000*). However, predictability of sales income was much more important: firms that reported 'variable and unpredictable sales' were much more likely to report VAT payments as causing a cash flow problem (χ^2 *0.000*).

There was an expectation that businesses experiencing financial problems would also find the timing of VAT payments difficult. The data show that businesses making a profit, or recording a better profit performance than in the previous 12 months, were less likely to state that making VAT payments was a critical or major cash flow problem (Table 5.4). However, businesses that had 'broken even' were more likely to find VAT payments causing or contributing to a critical or major cash flow problem (χ^2 *0.000*).

What these findings show is that it tends to be a combination of nature of the product market within which the business operates and the performance of the business that affects the impact of the timing of VAT payments on cash flow. Whether payments are a problem is likely to depend heavily on the cash position of the business.

> ''It's not so much a problem, as long as you've got the money in the bank at the time! … In general, well, for the last five years, we haven't had a problem. We're quite liquid at the moment. We've got quite a good cash flow. So we haven't had a problem. We have had problems in the past and we have incurred penalties." (WE12: plumbers merchant, 5 workers)

This position was reiterated in a number of interviews and quite clearly having the cash to meet a deadline and the impact of the timing of tax payments are inextricably linked. Another business owner, running a prosperous business, reported no problems in paying VAT:

> ‘‘If you would have asked me this five years ago when we were undergoing a difficult time and we only had two months of operating cash (rather than four months) then my answers would have been completely different.” (RB1: Industrial Ceramics. 12 workers)

The problem of the conventional VAT payment method is that it is based on invoices issued rather than cash received. So where clients pay late, or not at all, the business incurs a VAT bill before receiving payment for products or services provided. This was the rationale for the introduction of the Cash Accounting Scheme. But only businesses with an annual turnover of less than £660k are eligible for this scheme. The following comments come from a construction business owner with an annual turnover slightly higher than this.

> ‘‘The big problem with VAT is you pay VAT on invoices. Not on payments. So the problem is, if you’ve invoiced out a hundred grand, you owe seventeen and a half grand. You may not have that money. In which case, you are paying money. With PAYE you’ve paid the guys, you’ve got to pay it, and it’s their tax anyway – it’s never our money. That’s different. But when we’ve invoiced out and we’ve got to pay that money, regardless of whether you’ve been paid or not…” (WE7: builder, 9 workers)

Payment of a particular tax is not necessarily a problem because of the specific amount due to be paid. But when the timing of tax payments coincides with other payments businesses need to make, whether to suppliers, landlords or employees, then a specific tax payment can contribute to cash flow difficulties.

> “The only problem comes, I mean, before I had rent quarterly and VAT quarterly, it all comes sometimes at the same time. That affects the cash flow. Now I change the rent to monthly – instead of quarterly, I pay every month standing order. In a way, it is good to have monthly; otherwise, it all comes at the same time, it does affect the cash flow...” (JK6: restaurant, 12 employees)

5.3 Payment of PAYE and Employer NICs: Methods and Effects

Almost a half of the businesses (44.1%) paid PAYE and 39.9% Employer NICs for employees (see Appendix 2; Q22). The most common timing of these payments was monthly (69.3% for PAYE and 69.7% for Employer NICs) followed by quarterly (21.1% and 22.9% respectively (Table 5.5). Note should be made of the small number of respondents reporting annual PAYE payments. As PAYE is generally paid when employers pay employees and most of these respondents employed others, it seems highly likely that PAYE payments would be made either monthly or quarterly rather than annually. Under very specific conditions company directors and the self-employed can make annual PAYE payments. Although we cannot be certain this is not due to incorrect data recording, experience of the face-to-face interviews suggests that owner-managers' awareness of tax payment methods varies considerably ; many rely on their accountants to inform them of when and how to make payments. Therefore, erroneous replies are more likely to derive from lack of respondent awareness of particular methods than data capture mistakes.

Table 5.5

Payment of Employers' PAYE and NICs		
	PAYE	ENICs
Monthly	69.3	69.7
Quarterly	21.1	22.9
Annually	5.6	2.8
Other	1.8	1.2
Don't Know	2.3	3.4
Weighted N	386	349
Unweighted N	634	600

Source: SBRC HMRC Business Survey, 2005

An analysis of PAYE and Employer NICs payments shows that these do not generally cause or contribute to cash flow problems for businesses (Table 5.6). There were few major differences linked to business characteristics although firms in

Construction and those in the middle turnover sizebands were more likely to report PAYE and ENIC payments as contributing to cash flow problems. What is also important in these findings is the unstable relationship with size of business, measured in terms of either employment or financial turnover.

Table 5.6

Business Context: When it comes time to pay PAYE and Employers' NICs does this cause, or contribute to …					
	A Critical Cash flow problem	**A Major Cash flow problem**	**A Minor Cash flow problem**	**No problem at all**	**All**
Size	%	%	%	%	
1-4	2.4	10.9	33.0	53.7	339
5-9	2.8	8.3	33.3	55.6	36
10-49	4.0	12.0	28.0	56.0	25
All	2.5	10.8	32.8	54.0	400
Turnover					
Under £58,000	0.0	16.2	27.0	56.8	37
£58k-£149,999	0.0	10.6	21.9	67.5	160
£150k-249,999	10.1	6.7	50.6	32.6	89
£250k-£659,999	1.4	12.7	33.8	52.1	71
£660k-£1.5m	0.0	3.1	34.4	62.5	32
All	2.6	10.0	32.1	55.3	389
Registered for VAT	2.8	9.6	33.6	54.0	354
Legal Status					
Self Employed Sole trader	3.0	9.6	38.5	48.9	135
Partnership	0.0	6.3	18.8	75.0	48
Ltd company	2.3	12.6	32.1	53.0	215
All	2.3	10.8	32.7	54.3	398
Sector					
Primary	0.0	0.0	33.3	66.7	9
Manufacturing	5.3	18.4	34.2	42.1	38
Construction	5.3	12.0	37.3	45.3	75
Consumer Services	2.9	6.6	34.6	55.9	136
Business Services	0.0	12.6	28.0	59.4	143
All	2.5	10.7	32.7	54.1	401

Source: SBRC HMRC Business Survey, 2005

When business processes and performance are examined, firms reporting a 'more or less permanent' or 'frequent' cash flow problem were more likely to report a problem with the timing of PAYE and Employer NICS payments (Table 5.7). Businesses making a loss in the previous year or reporting a worse profit performance than the

year previously were more likely to state this had caused a problem than those breaking even or making a profit ($\chi^2$0.003). But, this was still a minority (6.7% of businesses making a loss also reported this a 'critical' cash flow problem).

Table 5.7

Business Process and Performance: When it comes time to pay PAYE and Employers' NICs does this cause, or contribute to…					
	A Critical Cash flow problem %	**A Major Cash flow problem %**	**A Minor Cash flow problem %**	**No problem at all %**	**All**
Cash Flow Problem ***					
Permanent	5.6	21.5	43.7	29.6	7.1
Frequent	6.4	14.9	48.9	29.8	94
Occasional or rare	0	5.6	22.3	72.1	233
All	**2.5**	**10.6**	**32.4**	**54.5**	**398**
Turnover previous 12 months					
Increase	0.6	6.1	35.0	58.3	163
Decrease	6.6	13.2	20.9	59.3	91
Stay the same	3.1	15.4	33.1	48.5	130
All	2.9	10.9	31.0	55.2	384
Profits 12 months **	%	%	%	%	%
Made a profit	2.3	9.0	27.3	61.3	256
Made a loss	6.7	8.3	45.0	40.0	60
Broke even	0.0	19.0	34.5	46.6	58
All	2.7	10.4	31.3	55.6	374
Profit performance previous year					
Better	0.7	13.8	22.4	63.2	152
Worse	6.5	4.7	41.1	47.7	107
The same	3.0	13.0	34.0	50.0	100
All	3.1	10.9	31.2	54.9	359
Employment Growth ***					
Growing	1.2	11.1	24.7	63.0	81
Stable	1.2	12.0	37.8	49.0	249
Shrinking	9.7	5.6	23.6	61.1	72
All	2.7	10.7	32.6	54.0	402

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

For some respondents, the timing of PAYE payments can cause cash flow problems. For one business owner, PAYE payments were due on the 19th of every month but as many clients paid their bills at the month-end, this meant there was a period of about a week to ten days when the business faced cash flow difficulties.

> "… A lot of companies pay on a monthly basis, and we've gone to four-weekly. So if you're paying four-weekly or monthly, and you're only going to get your cash at the end of the following month, then it might be helpful to the business to pay your PAYE round about when cash is coming into the business – which is monthly, at the end of the month. That would be more helpful. The 19th is almost the middle of the month … Richmond will pay on the 28th so the money's in our account on the 29th. So if the PAYE was paid at that time, we would always have the money to write the cheque there and then. Not having to duck and dive with them for two weeks or a week. Although as I said we have the overdraft facility I can use, but I want to keep the overdraft for absolute emergencies. Generally, it's PAYE I'm having to use it for." (JK2: social care services, 36 employees)

5.4 Payment of Corporation Tax: Methods and Effects

A third of sample businesses (34.7%) were limited companies and, in principle, eligible to pay Corporation Tax (see Appendix 2; Q17). Only those companies reporting annual taxable profits of £10,000 or more are required to pay Corporation Tax; moreover, companies can offset losses in previous years against current profits. Just over two thirds (68%)[8] of limited companies in the sample reported paying Corporation Tax: around a third claimed not to be making profits.

For most companies the payment of Corporation Tax is due nine months and one day after the end of the accounting period (the 'normal due date'). Failure to pay the correct amount of Corporation Tax by the due date can lead to companies incurring an interest charge on the tax underpaid. Conversely, payment made before the due date can lead to companies being entitled to an interest on the payment. The bulk of

[8] 34.7% of the sample were registered as private limited companies, of which 68% paid Corporation Tax (calculated from Q19 in Appendix 2)

sample companies paying Corporation Tax (62.6%) reported payment on the due date but 14.3% reported late payment and 14.5% reported early payment (Table 5.8).

Corporation Tax payments were more likely to generate timing problems for eligible businesses than other taxes.

Table 5.8

When do you usually pay Corporation Tax?	
At the due date	62.6
Earlier than the due date	14.5
Later than the due date	14.3
Don't Know	8.7
Weighted N	219
Unweighted N	362

Source: SBRC HMRC Business Survey, 2005

A quarter of owner-managers (23.2%) reported the payment of Corporation Tax as causing a 'critical' or 'major' cash flow problem (see Appendix 2; Q19). A distinctive pattern in the results suggests it is businesses in the middle size bands (5-9 employees; and £150-£249k turnover) that are more likely to report payment of Corporation Tax as a 'critical' or 'major' cash flow problem (Table 5.9). Businesses in Construction (11.8%) were again more likely to state that this payment caused or contributed to a critical or major cash flow problem.

Table 5.9

Business Context: When it comes time to pay Corporation Tax does this cause, or contribute to …					
	A Critical Cash flow problem	**A Major Cash flow problem**	**A Minor Cash flow problem**	**No problem at all**	**All**
Size	%	%	%	%	
1-4	9.1	15.9	32.4	42.6	176
5-9	11.1	16.7	38.9	33.3	18
10-49	0.0	8.3	50.0	41.7	12
All	8.7	15.5	34.0	41.7	206
Turnover					
Under £58,000	12.9	0.0	22.6	64.5	31
£58k-£149,999	4.8	11.3	40.3	43.5	62
£150k-249,999	13.3	26.7	28.9	31.1	45
£250k-£659,999	7.9	23.7	31.6	36.8	38
£660k-£1.5m	10.7	7.1	42.9	39.3	28
All	9.3	14.7	33.8	42.2	204
Registered for VAT	9.9	15.4	33.0	41.8	182
Legal Status					
Self employed Sole trader	0.0	0.0	37.5	62.5	8
Partnership	50.0	0.0	0.0	50.0	6
Ltd company	8.2	16.9	34.4	40.5	195
All	9.1	15.8	33.5	41.6	209
Sector					
Primary	0.0	0.0	0.0	100.0	2
Manufacturing	6.7	13.3	40.0	40.0	15
Construction	11.8	23.5	14.7	50.0	34
Consumer Services	9.8	14.8	41.0	34.4	61
Business Services	8.5	13.8	35.1	42.6	94
All	9.2	15.5	33.5	41.7	206

Source: SBRC HMRC Business Survey, 2005

An examination of the processes and performance of businesses shows that the timing of Corporation Tax payments appeared to be affecting expanding as well as declining firms (Table 5.10). Clearly, those that were more reliant on cash sales were also much more likely to report a major cash flow problem (50% compared with 15.4% for the sample as a whole).

Table 5.10

When it comes time to pay Corporation Tax does this cause, or contribute to …					
	A Critical Cash flow problem %	**A Major Cash flow problem %**	**A Minor Cash flow problem %**	**No problem at all %**	**All**
Cash sales ***					
None	8.3	11.5	29.2	51.0	96
Some	9.6	10.8	29.2	32.5	83
100%	0.0	50.0	13.6	36.4	22
All	**8.0**	**15.4**	**34.8**	**41.8**	**201**
Sales predictability **					
No variation	6.5	17.4	43.5	32.6	46
Variable but predictable	11.6	2.3	20.9	65.1	43
Variable and unpredictable	8.4	20.2	34.5	37.0	119
All	**8.7**	**15.9**	**33.7**	**41.8**	**208**
Cash flow problems ***					
Permanent	12.1	42.4	27.3	18.2	33
Frequent	11.9	23.8	45.2	19.0	42
Occasional or rare	6.9	6.1	31.3	55.7	131
All	**8.7**	**15.5**	**33.5**	**42.4**	**206**
Turnover previous 12 months ***	%	%	%	%	
Increase	17.0	8.0	25.0	50.0	88
Decrease	2.1	20.8	39.6	37.5	48
Stay the same	3.3	26.7	36.7	33.3	60
All	9.2	16.8	32.1	41.8	196
Profits 12 months					
Made a profit	4.4	16.9	39.7	39.0	136
Made a loss	0.0	15.4	26.9	57.7	26
Broke even	32.1	3.6	17.9	46.4	28
All	7.9	14.7	34.7	42.6	190
Profit performance previous year *					
Better	7.7	9.0	28.2	55.1	78
Worse	5.6	20.4	37.0	37.0	54
The same	14.3	26.5	28.6	30.6	49
All	8.8	17.1	30.9	43.1	181
Employment Growth *					
Growing	11.9	7.1	21.4	59.5	42
Stable	8.4	14.3	37.0	40.3	119
Shrinking	6.4	27.7	36.2	29.8	47
All	8.7	15.9	33.7	41.8	208

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

Payment of Corporation Tax was more likely to be reported as causing a critical cash flow problem by businesses with a 'more or less permanent' general cash flow problem ($\chi^2$0.000.). For example, only 18.2% of businesses stating that cash flow problems were 'more or less a permanent state of affairs' said that the timing of

Corporation Tax payments was 'no problem at all' compared with 55% having 'occasional or rare' cash flow problems. Such a pattern in the survey data is consistent with the argument that the effects of the timing of tax payments are connected to the financial state of the business at the time of payment.

5.5 Personal Income Tax and NIC Payments

Owner-managers can pay their own personal income tax and NICs in two ways: through PAYE, self-assessment or both. Just over a half of the owner-managers paid income tax by self-assessment (51.2%) whilst 20.0% used PAYE and 18.1% used both (Table 5.11). There were minor differences in the payment of NICs with 34.9% paying through PAYE, probably reflecting the ability to combine the payment with that for their employees.

Table 5.11

Types of Main Income Tax/NICs Payment of by Owner-Managers		
	Income Tax %	NICs %
PAYE	20.0	34.9
Self-assessment	51.2	36.9
Both PAYE and Self-assessment	18.1	11.6
Do not pay (income tax/NICs)	4.4	5.9
*Dealt with by accountant	0.8	0
*Direct debit	n/a	1.7
Other	0	0.6
Don't Know	5.5	8.5
Refused	0	0
Weighted N	875	875
Unweighted N	875	875
Notes: new categories added (*) following post-coding of initial 'other' responses.		

Source: SBRC HMRC Business Survey, 2005

Personal income tax payments were most commonly made twice a year (42.3% of owner-managers) followed by once per year (24.3%). Payment of NICs was more in line with the payment of PAYE, that is on a monthly basis (56.7%) followed by quarterly payments (19.6%; see Appendix 2; Q20d).

Table 5.12

Business Context: When it comes time to pay your own personal income tax does this cause, or contribute to …					
	A Critical Cash flow problem	**A Major Cash flow problem**	**A Minor Cash flow problem**	**No problem at all**	**All**
Size	%	%	%	%	
1-4	3.0	12.2	33.8	51.0	761
5-9	5.0	10.0	30.0	55.0	40
10-49	4.0	12.0	24.0	60.0	25
All	3.1	12.1	33.3	51.5	826
Turnover					
Under £58,000	3.6	11.0	34.9	50.5	281
£58k-£149,999	2.6	9.7	38.6	49.1	267
£150k-249,999	3.7	19.3	28.1	48.9	135
£250k-£659,999	4.4	11.0	29.7	54.9	91
£660k-£1.5m	0.0	16.7	8.3	75.0	36
All	3.2	12.2	33.2	51.4	810
Registered for VAT	2.5	12.2	34.3	51.1	607
Legal Status **					
Self employed Sole trader	4.0	14.0	37.2	44.9	401
Partnership	2.9	10.9	34.1	52.2	138
Ltd company	1.8	9.5	27.8	60.9	284
All	3.0	11.9	33.4	51.6	823
Sector **					
Primary	0.0	10.3	25.6	64.1	39
Manufacturing	3.0	10.4	38.8	47.8	67
Construction	6.9	4.6	30.1	58.4	173
Consumer Services	2.5	13.4	37.3	46.8	284
Business Services	1.9	16.0	30.9	51.1	262
All	3.2	12.0	33.3	51.5	825

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

Payment of personal income tax and NICs presented a critical cash flow problem for only 3.0% and a major cash flow problem for 11,7% of businesses (see Appendix 2; Q21). There were few distinctive business characteristics that stood out as having a strong relationship with a critical or major cash flow problem (Table 5.12). However, self-employed sole traders ($\chi^2$0.006 for legal status differences) and Construction businesses ($\chi^2$0.002 for sector differences). were more likely to report a problem over the timing of this payment (Table 5.12).

An examination of business processes and performance also reveal some interesting patterns in the data (Table 5.13). Those businesses reporting a loss ($\chi^2$0.000 for profit performance) or those experiencing a decline in sales turnover ($\chi^2$0.000) were much more likely to report that payment of personal income tax causes major cash flow problems.

Table 5.13

Business Processes and Performance: When it comes time to pay your own personal income tax does this cause, or contribute to …					
	A Critical Cash flow problem %	**A Major Cash flow problem %**	**A Minor Cash flow problem %**	**No problem at all %**	**All**
Cash flow problem ***					
Permanent	0.7	35.0	30.7	33.6	137
Frequent	10.6	19.0	43.0	27.5	142
Occasional or rare	1.7	4.1	31.7	62.6	543
All	**3.0**	**11.8**	**33.5**	**51.7**	**822**
Turnover previous 12 months ***					
Increase	1.6	9.4	30.3	58.8	320
Decrease	1.5	24.0	30.1	44.4	196
Stay the same	4.5	8.2	37.0	50.2	243
All	2.5	12.8	32.4	52.3	759
Profits 12 months					
Made a profit	3.6	10.1	34.8	51.4	552
Made a loss	3.1	20.8	27.1	49.0	96
Broke even	2.3	11.5	29.0	57.3	131
All	3.3	11.7	32.9	52.1	779
Profit performance previous year ***					
Better	3.8	9.9	29.1	57.2	313
Worse	2.7	19.8	27.8	49.7	187
The same	0.9	8.3	43.7	47.2	229
All	2.6	11.9	33.3	52.1	729
Employment Growth					
Growing	5.8	13.1	26.3	54.7	137
Stable	2.3	11.9	36.5	49.3	570
Shrinking	4.2	11.8	26.1	58.0	119
All	3.1	12.1	33.3	51.5	826

Source: HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

Clearly, these relationships are complex but do suggest that business performance will influence the effect of the timing of individual owner's tax payments on the

business' ability to pay. Firms undergoing steady growth may have to raise more funds for taxation as they meet new thresholds whilst those less profitable may simply be struggling to raise the necessary funds.

5.6 Sources of Taxation Payments

Owner-managers were asked how they make taxation payments and how these choices affect cash flow. For instance, business owners can fund tax payments from their ordinary business bank account, from a separate bank account created specially for the purpose, from a bank overdraft or using other means. Overall, the bulk of businesses (72.1%) claimed to put the cash raised for taxation towards their ordinary bank account (Table 5.14). A significant proportion also put cash into a separate account (18.9%). When asked the *main* use of this cash, 71.4% of businesses put this into their ordinary business account.

Table 5.14

What do you do with the money accrued for taxation before making tax payments?		
	Use	Main
Add it to your ordinary business bank account?	72.1	71.4
Put it into a separate account ?	18.9	16.3
Reduce interest payments on overdraft borrowing	8.4	5.3
Pay off Bank Loan	3.0	1.7
*pay suppliers earlier	0.7	0.3
*buy more raw materials or stock	0.9	0.3
*add to bank savings	1.9	0
*pay wages & salaries	0.6	0
Other use	2.0	2.1
Don't Know	1.5	2.6
None of these ways	3.1	NA
Weighted N	859	826
Unweighted N	868	839
Notes: new categories added (*) following post-coding of initial 'other' responses; 'use' column sums to more than 100% due to multiple choice.		

Source: SBRC HMRC Business Survey, 2005

In the face-to-face interviews, several business owners reported 'putting money aside' to be able to make tax payments on time by creating separate bank accounts. One business owner reported a particular problem with his own personal income tax and NIC payments. Because this was paid by self-assessment twice a year, each payment was relatively large. To address this, he created a bank savings account to be able to meet the payment when it became due.

> "It can [cause problems] because we've been paying our tax and national insurance in January and July and so you've got two big hits rather than, as we've been discussing, spreading things out. It hasn't really caused problems because I made provision for that, anticipating what our payments are going to be so I set money aside monthly for that. So it hasn't generally been a problem … I put a certain amount of money into a savings account on a monthly basis so it's there when the tax bill comes." (JK3: retailer, 5 staff)

> "I keep it separately. Say I earn a hundred pounds on a job, I put twenty five percent of that into an account - which I don't use. So that covers my tax and national insurance. So I'm never surprised with the bill, thinking 'my god, it comes to more! … I don't like surprises." (WE5: catering services, 1 employee)

Another business owner reported holding a separate tax account as well as a general business account in order to ensure sufficient cash was available to meet tax obligations. She reported that each time a client payment was received, however small, 25% of the money received was deposited in the dedicated tax account. This practice arose after discussions with her accountant. Initially, the accountant advised the respondent to put 15-18% of all sales income into the tax account; to be safe, the owner responded by transferring 30% of income into the account. Because tax planning has so far been successful, she decided to reduce the proportion of sales income placed within the tax account to 25%.

> "I have an account I use purely for business so any money I earn goes into there. I have a tax account as well so I take off twenty five percent of everything that I earn and pay it into the account, a savings account, so I'm building up money for my tax bill. Some interest is paid on that which we use as a bit of a safety net. So we made sure we had enough for my tax bill, maybe with a little bit left over that would give me a start the following year…" (JK7: PR consultant, 1 employee)

Because the account contained a residual amount after tax payments had been made, partly because she deliberately deposited more cash than needed and partly because the account earned interest, the account also provided a 'safety net' to cope with other non-tax-related cash flow difficulties. The owner reported using the account sparingly for these purposes:

> "… Because I know that I'm covered, if I had a serious dip in cash flow, I know that I can borrow from that account. It works. It's a real safety net for me. It means that the money's there for tax. And it also means that I can borrow small amounts from it if I need it to just to see me through to when I get paid so I don't have to take out a bank loan…" (JK7: PR consultant, 1 employee)

Other business owners, though recognising the benefits of putting money aside in a separate bank account to meet tax payments, felt unable to do so. Where businesses require large amounts of working capital to operate, it may simply not be possible to put money aside in this way. The following owner, of an accountancy practice, reported using the business' overdraft facility every month to meet cash requirements. Rather than being able to create a separate bank account for tax payments, income was used to keep the overdraft under its £250k limit. Moreover, she claimed that her bank would not let her open another bank account if they were running an overdraft on another one.

> "We know at the end of each month what the VAT liability is for that month – or Graham [Office Manager] does. And he factors it into – because essentially he's playing with cash – and he factors it in to cash flow. He knows it's got to go out at that point. He would, ideally, like to be able to sort that money away into a deposit account but we've never been in a position to be able to do that … Because we need so much working capital that we can't afford to take amounts out of that and put it to one side. So it got used as working capital. But it's very much included in the cash flow and factored in." (JK4: accountant, 22 employees)

Several other business owners made similar points about the difficulty of organising their finances to ensure tax payment deadlines could be met.

Limited working capital arising either from low sales income, late payment by clients, or the need to pay suppliers, landlords and employees meant it simply was not possible to ring-fence a particular source of cash as earmarked for tax payment purposes.

> "Again, it is a question of juggling finances to make sure that that money is available. You can't plan specifically, I mean, cash flow is something we look at all the time… for a small business like this we are not in a position where we've got a whole bunch of money sitting in the bank. That just doesn't happen. We've got leases and salaries and all the rest of it and when we've got any spare cash there's always something we need to spend it on so we're just always making sure we've got enough to cover so the planning is no more sophisticated than that." (KB4: printer, 12 employees)

> "Sometimes it's separate and sometimes it's bundled together. It just depends. For instance, I tried to be good last quarter and put some aside for the VAT and I managed that. So I paid it out of a separate account. But there will be times when it will just be a case of grabbing whatever cash resource is available and just making out the cheque from wherever it is."

> "The problem with us, as a hand-to-mouth business, is that you never have the benefit of being able to say, 'put that money in the bank and smoke it'. So, all that happens is you stretch the cash-flow burden when you have to pay." (WE2: software services, 8 employees)

> "On paper, yes, if you are doing very well and you're getting that money in, then it's great. In my case, it's just part of cash flow. The problem with architectural practices, and I've worked in a number, is that from what one hears as an employee but certainly from running this place for seventeen years odd, is that what you get for what you do, is disproportionately low…" (WE6: architect, 2 workers)

5.7 Cash Flow Benefits Associated With Tax Payments

Because tax payments are required some time after liability has accrued, business owners have, in principle, access to cash resources which in due course will need to be paid to the tax authorities. For Corporation Tax, this period can be nine months; for income tax paid under self-assessment, the period is six months; for VAT the period is usually three months; for PAYE, the period may be only a month. During

this period, business owners are able to deploy these resources productively towards profit-generating activities. Of course, any attempt to use these cash resources must be tempered by the need to retain sufficient liquidity to meet tax payments and other deadlines if their businesses are not to suffer.

Owner managers were asked if they regarded the time-lag between accrual of tax liability and payment as providing a cash flow benefit. Overall, more than two-thirds (63.2%) stated that it 'made no real difference' and about a third (31%) reported that this was a benefit for the business, but only 13% felt this was a 'major' benefit (See Appendix 2; Q27). There were only minor differences in views according to size of business (employment or turnover), legal status, sector or profit performance. However, businesses registered for VAT were more likely to state that deferred tax payment was a major or minor benefit for the business: clearly they were able to hold onto this money until the VAT payment deadline. To some extent this is to be expected and although this result is statistically significant ($\chi^2$0.000), the question may be asked as to why the perceived benefits are not greater?

Table 5.15

Would you describe having cash available because tax payments are made some time after accrual of liability….				
	A major benefit for cash flow	**A minor benefit for cash flow**	**Or it makes no real difference**	**All**
Size	%	%	%	%
1-4	13.4	19.0	67.6	747
5-9	15.4	23.1	61.5	39
10-49	16.0	24.0	60.0	25
All	13.6	19.4	67.1	811
Turnover				
Under £58,000	12.0	16.7	71.3	275
£58k-£149,999	14.1	22.1	63.7	262
£150k-249,999	13.5	24.6	61.9	126
£250k-£659,999	17.2	15.1	67.7	93
£660k-£1.5m	17.5	17.5	65.0	40
All	13.8	19.6	66.6	796
Registered for VAT ***	15.4	21.8	62.8	592
Legal Status *				
Self employed sole trader	10.3	17.3	72.4	399
Partnership	14.2	19.7	66.1	127
Ltd company	17.8	22.1	60.1	281
All	13.5	19.3	67.2	807
Sector				
Primary	0.0	11.1	88.9	36
Manufacturing	10.9	15.6	73.4	64
Construction	13.6	15.9	70.5	176
Consumer Services	14.6	20.1	65.3	268
Business Services	14.8	22.7	62.5	264
All	13.5	19.3	67.2	808

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

An examination of business processes and context shows that growing and more profitable businesses are more likely to report perceived major cash flow benefits (Table 5.16). However, the differences are small and not statistically significant. Interestingly, those having 100% cash sales were marginally less likely to report benefits from the accrual of taxation payments ($\chi^2$0.005).

Table 5.16

Business Process and Performance: Would you describe having cash available because tax payments are made some time after accrual of liability….				
	A major benefit for cash flow %	**A minor benefit for cash flow %**	**Or it makes no real difference %**	**All**
Cash sales **				
None	13.7	17.9	68.4	285
Some	15.0	24.9	60.2	321
100%	12.4	12.4	75.1	185
All	**13.9**	**19.5**	**66.6**	**100.0**
Turnover previous 12 months				
Increase	14.3	20.5	65.1	307
Decrease	11.2	20.3	68.5	197
Stay the same	15.9	13.4	70.7	239
All	14.0	135	504	743
Profits 12 months				
Made a profit	14.6	20.2	65.2	549
Made a loss	14.0	16.1	69.9	93
Broke even	10.9	15.1	73.9	119
All	13.9	18.9	67.1	761
Profit performance previous year				
Better	16.0	16.7	67.3	312
Worse	12.8	18.2	69.0	187
The same	12.7	18.1	69.2	221
All	14.2	17.5	68.3	720
Employment Growth				
Growing	18.2	18.2	63.6	132
Stable	12.2	20.4	67.4	559
Shrinking	14.5	15.4	70.1	117
All	13.5	19.3	67.2	808

Source: HMRC Business Survey, 2005

Note: *** χ^2 *significant at the 99.9% level;* ** χ^2 *significant at the 99% level;* * χ^2 *significant at the 95% level*

The reasons why so few business owners perceived a cash flow benefit arising from the time-lag between accrual of tax liability and date of payment were several. First, only a minority of businesses were eligible for Corporation Tax and, therefore, able to take advantage of the 9-month period prior to making tax payments at the due date.

Second, the amounts of money involved were often considered insignificant in the bigger cash flow picture, especially where the time period is short (e.g. PAYE is paid monthly by most). Third, for many owners, any cash flow benefits were felt to be outweighed by the costs associated with the effort of being unpaid tax calculators and collectors for the Government.

> "It should be really because you've got the benefit of time so you're paying after the event if you like. But, I think, in reality, it probably isn't because you get so used to it, it just becomes sort of automatic that you've got this time lag and you more or less forget about it really." (JK3: retailer, 5 staff)

> "I think it would be quite fair to say businesses don't see that as a cash flow advantage at all. They see it as quite a strict deadline that they have to adhere to. They're basically collecting money for the Revenue which they then have to pass on. So I've never heard anybody say 'I think it's really nice that we get the nineteen day leeway'." (JK4: accountant, 22 employees)

> "I don't think it's a benefit. It's not a large amount. If cash was tighter, I could see the need for a lot more planning because every quarter we've got a cheque to go out." (RB1: manufacturing, 12 employees)

5.8 Difficulties in Meeting Deadlines for Taxation Payments

Meeting taxation deadline payments presented difficulties for almost a third (31.0%) of businesses (Table 5.17). There is a positive statistical relationship between financial size of business and ability to meet payments ($\chi^2$0.000), although this is not wholly linear (Table 5.17). Firms registered for VAT and/or incorporated were more likely to report a difficulty, obviously reflecting the increased probability of having to make VAT and Corporation Tax payments. In relation to legal status, however, partnerships were much less likely to report difficulties meeting tax deadlines than either limited companies or self-employed sole traders. Businesses in Construction and Business Services were also more likely to report difficulties. With the exception of employment size, all the above relationships were statistically significant.

Table 5.17

Business Context: Over the last two years has there been an occasion when you have had difficulty in meeting a deadline for payment to Inland Revenue or Customs and Excise?			
	Yes	**No**	**All**
Size	%	%	%
1-4	30.4	69.6	805
5-9	40.5	59.5	42
10-49	34.6	65.4	26
All	31.0	69.0	873
Turnover ***			
Under £58,000	21.2	78.8	306
£58k-£149,999	35.8	64.2	271
£150k-249,999	39.3	60.7	140
£250k-£659,999	33.0	67.0	100
£660k-£1.5m	45.0	55.0	40
All	31.3	68.7	857
Registered for VAT ***	35.2	64.8	631
Legal Status ***			
Self employed sole trader	33.3	66.7	426
Partnership	17.9	82.1	145
Ltd company	34.2	65.8	301
All	31.1	68.9	872
Sector *			
Primary	7.3	92.7	41
Manufacturing	27.2	72.5	69
Construction	33.9	66.1	180
Consumer Services	30.6	69.4	301
Business Services	34.2	65.8	281
All	31.1	68.9	872

Source: SBRC HMRC Business Survey, 2005

Note: $^{***}\chi^2$ significant at the 99.9% level; $^{**}\chi^2$ significant at the 99% level; $^{*}\chi^2$ significant at the 95% level

There appear to be strong relationships between having a difficulty in making a payment deadline and the business making a loss in the previous 12 months: 41.8% of these firms reported a difficulty in making a payment over the last two years compared with 28.2% that had made a profit (Table 5.18). As expected, firms with

permanent cash flow problems were much more likely to report difficulties in meeting tax deadlines ($\chi^2$0,000.).

Table 5.18

Business Processes and Performance: Over the last two years has there been an occasion when you have had difficulty in meeting a deadline for payment to Inland Revenue or Customs and Excise?			
	Yes %	**No %**	**All**
Cash Sales *			
None	31.4	68.6	303
Some	35.2	64.8	335
100%	25.1	74.9	211
All	**31.3**	**68.7**	**849**
Cash flow problems * **			
Permanent	58.5	41.5	147
Frequent	48.3	51.7	149
Occasional or rare	19.4	80.6	572
All	**31.0**	**69.0**	**868**
Turnover previous 12 months * **	%	%	
Increase	34.1	65.9	328
Decrease	41.9	58.1	210
Stay the same	23.4	76.6	261
All	261	538	799
**Profits 12 months ** **			
Made a profit	28.2	71.8	577
Made a loss	41.8	58.2	110
Broke even	39.2	60.8	130
All	31.8	68.2	817
Profit performance previous year *			
Better	31.1	68.9	322
Worse	40.4	59.6	203
The same	29.9	70.1	241
All	254	512	766
Employment Growth			
Growing	23.9	76.1	142
Stable	31.3	68.7	604
Shrinking	37.6	62.4	125
All	31.0	69.0	871

Source: SBRC HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

5.9 Experiences of Fines for Not Meeting Payment Deadlines

Just over a quarter of the businesses (26.6%) reported having ever received a penalty fine for not meeting a tax payment deadline (see Appendix 2; Q34). Of those reporting fines, the most common penalty was for personal income tax and NICs (41.1%) followed by VAT (32.7%) (Table 5.19)

Table 5.19

Fines Received For Not Meeting a Deadline to Inland Revenue or Customs and Excise	
Personal Income Tax and NICs	41.1
VAT	32.7
PAYE and Employers NICs	21.1
Corporation Tax	7.7
Other	3.3
Don't Know	4.0
Weighted N	233
Unweighted N	260

Source: SBRC HMRC Business Survey, 2005

The types of businesses most likely to have received a fine are shown in Table 5.20. A number of distinctive characteristics stand out. Larger firms in the sample and those involved in Construction and Consumer services reported a higher than average incidence of receiving a fine. However, none of these relationships are statistically significant.

Table 5.20

Have you ever received a penalty or a fine for not meeting a payment deadline?			
	Yes	**No**	**All**
Size	%	%	%
1-4	26.3	73.7	805
5-9	32.5	67.5	40
10-49	30.8	69.2	26
All	26.8	73.2	871
Turnover *			
Under £58,000	21.2	78.8	306
£58k-£149,999	30.1	69.9	272
£150k-249,999	22.3	77.7	139
£250k-£659,999	33.0	67.0	100
£660k-£1.5m	37.5	62.5	40
All	26.4	73.6	857
Registered for VAT	28.1	71.9	630
Legal Status			
Self employed sole trader	27.5	72.5	426
Partnership	22.2	77.8	144
Ltd company	28.0	72.0	300
All	26.8	73.2	
Sector			
Primary	14.6	85.4	41
Manufacturing	20.6	79.4	68
Construction	28.9	71.1	180
Consumer Services	28.6	71.4	304
Business Services	26.5	73.5	279
All	26.7	73.3	872

Source: SBRC HMRC Business Survey, 2005

Note: $^{***}\chi^2$ significant at the 99.9% level; $^{**}\chi^2$ significant at the 99% level; $^{*}\chi^2$ significant at the 95% level

An examination of business processes and performance shows that turnover and profitability have mixed associations with receiving a penalty fine (Table 5.21). This suggests there are intervening factors in the relationship between financial performance and likelihood of receiving a fine. However, those businesses with only cash sales were less likely to have received a fine for not making a payment (χ

^{2}0,000). One possibility for this observation may be that firms more dependent on invoice sales were less likely to pay a tax demand because they had not yet received income on invoices raised.

Table 5.21

Businesses Processes and Performance: Have you ever received a penalty or a fine for not meeting a payment deadline?			
	Yes %	**No %**	**All**
Cash sales ***			
None	27.0	73.0	300
Some	33.5	66.5	334
100%	15.0	85.0	213
All	**26.6**	**73.4**	**847**
Cash flow problems **			
Permanent	30.6	69.4	144
Frequent	35.8	64.2	148
Occasional or rare	23.3	76.7	575
All	**26.6**	**73.4**	**867**
Turnover previous 12 months			
Increase	28.4	71.6	331
Decrease	30.5	69.5	210
Stay the same	27.0	73.0	259
All	28.5	71.5	800
Profits 12 months **			
Made a profit	25.7	74.3	575
Made a loss	17.9	82.1	112
Broke even	36.9	63.1	130
All	26.4	73.6	817
Profit performance previous year			
Better	30.0	69.9	322
Worse	25.9	74.1	205
The same	27.7	72.3	238
All	28.2	71.8	765
Employment Growth			
Growing	27.5	72.5	142
Stable	27.8	72.2	604
Shrinking	20.8	79.2	125
All	26.8	73.2	871

Source: HMRC Business Survey, 2005

*Note: *** χ^2 significant at the 99.9% level; ** χ^2 significant at the 99% level; * χ^2 significant at the 95% level*

5.10 Resolving Payment Difficulties

Owner-managers have a number of options when seeking to resolve tax payment difficulties. The most common approach reported is to submit the payment late (39.5%) or to use a bank over draft (37.6%) (Table 5.22). The results also show that owner-managers were prepared to negotiate payment terms with the tax authorities (27.3%) as well as delaying payment to suppliers (23.3%).

Table 5.22

Ways of Resolving Difficulties in Meeting Taxation Deadlines	
The payment was submitted late	39.5
Used bank overdraft to cover cash flow needs	37.6
Renegotiated payment terms with tax authorities	27.3
Delayed payment to suppliers	23.3
Used business savings to cover cash flow needs	22.3
Used bank loan to cover cash flow needs	11.5
Personal savings	6.7
It was resolved in some other way	4.1
Paid – but with difficulty	2.5
Issue was not resolved/still ongoing	1.8
Don't Know	1.8
Weighted N	271
Unweighted N	318

Source: SBRC HMRC Business Survey, 2005

5.11 Suggestions for Changes to the Timing and Method of Taxation Payments

Although the general picture is that the timing of tax payments does *not* present a major problem for most businesses, owner-managers do have ideas which will benefit their business and improving the efficiency of the system. All owner-managers were given the opportunity to comment on suggestions for improvement to

the methods and timing of taxation payments (Table 5.23). Our expectation that respondents would have suggestions was confirmed although 14.9% said *no changes* would benefit their business.

Table 5.23

Which, if any, of the following changes in the timing and method of payment of tax would benefit your business?		
	Change %	MAIN %
Being able to make tax payments in several instalments rather than a lump sum	66.5	50.2
To be able to earn interest on tax payments made ahead of the due date	54.1	13.5
Being able to avoid making several payments for different taxes at the same time	47.4	6.0
A greater variety of payment methods available	40.4	7.1
A longer period between accrual of tax liability and date of payment	38.6	13.2
Any other change	10.7	10.0
None – no changes would benefit your business	14.9	N/A
Don't know	1.2	N/A
Weighted N	875	615
Unweighted N	875	627

Source: SBRC HMRC Business Survey, 2005

It is quite clear that owner-managers were keen on the ability to make tax payments in installments rather than in one lump sum: two-thirds (66.5%) agreed with this suggestion. This was also the *main* change preferred by business owners (50.2%). Other suggestions, including 'being able to earn interest on tax payments made ahead of due date', 'avoiding making several payments for different taxes at the same time' and 'a greater variety of payment methods' available were also popular.

The survey data suggest that many owner-managers perceive ways in which the tax system could be changed to better suit them. However, these suggestions should also be set against what methods and payment timings are already available. In

some cases, owner managers may not be aware of the options available or be reluctant to change their tax payment methods principally because they have always worked in a certain way, or are following their accountant's advice. Hence one policy implication may be to raise awareness among business owners of the range of tax payment options currently available as considerations of other changes which might improve business owners' ability to make tax payments.

- more frequent instalments might be useful:

  "… It might be easier to budget £100 going out every month, a bit like your gas bill by direct debit. I can certainly see that being a benefit, because then I know I'm paying bits and pieces off. Rather than have in six months time my accountant saying, 'Right, your tax is 1700 quid'! Ah! …" (WE1: retailer/training services, 1 employee)

- "It would be much better … if there was a system where you could pay in every month sort of like on account [i.e. direct debit] and then have periods where it was worked out and you would add a bit [if] there is a bit of a deficit. I think that would be a much more acceptable way of doing it. Also from the Inland Revenue's perspective they would have a steady flow of income" (WE11: financial services, 5 workers)

A key message from the face-to-face interviews was the notion of paying in small amounts rather than having to pay large lumps infrequently.

5.12 Summary and Conclusions

The payment of taxes is a major outgoing for most small businesses. Ensuring that sufficient working capital is available to meet tax obligations is recognised as a key task by owner-managers. This Chapter has covered a range of issues in relation to the payment of taxation. A number of key points have emerged.

- Business owner's experiences of cash flow problems associated with the payment for the four types of taxation were restricted to a minority, albeit a sizeable one, most notably for Corporation Tax where almost a quarter of respondents reported CT payments caused, or contributed to, cash flow problems.

- For most business owners, tax payments were financed from their ordinary business bank accounts. Overdraft borrowing to cover payments was also frequently reported. Only a third of business owners reported putting money aside to meet tax payments suggesting some might be able to meet tax deadlines if they organised their finances better. Of course, it cannot be assumed that not 'putting money aside' for tax payments necessarily indicates bad tax planning. Successful businesses that are highly liquid – or at least, not in debt – might be able to meet tax payment deadlines without setting up separate bank accounts or making other separate provision.

- Few business owners perceive the cash available between the accrual of various tax liabilities and the payment dates as providing a cash flow benefit for businesses. For most taxes, either the amounts were too small or the period for which it was held was too short for such cash assets to be considered substantial enough to offer any great benefit. For some, any cash benefit was outweighed by the costs associated with acting as what they perceived to be a tax calculator and tax collector for Government.

- All business are aware of the penalties associated with failure to meet deadlines and several had incurred them.

- Suggestions for improving the taxation system emphasised an increase in flexibility of payments and probably the need to pay more frequently to avoid the build up of accrued funds.

Chapter Six: A Multivariate Analysis of the Impact of Tax Payments on Cash Flow

6.1 Introduction

The preceding Chapter identified uneven effects of the timing and method of tax payments on small businesses. A number of bi-variate analyses have demonstrated how the timing and method of tax payments have led to uneven outcomes for the sample of small firms in terms of having a 'critical', 'major', 'minor' or 'no effects' on cash flow. In identifying which types of firms are most likely to be affected, and under what conditions, the analysis has revealed some differences in effects according to business characteristics (e.g. size, sector and legal status) and processes and performance (e.g. types of sales and purchases, turnover growth and profitability).

However, the analysis has also recognised the difficulties in identifying distinctive and stable relationships between business characteristics and the way in which the payment of taxation affects business cash flow. Given the complexity of identifying precise relationships between business characteristics and the effects of a particular tax payment, this chapter uses a series of multivariate models to establish the range of independent influences on the likelihood of a small business reporting the payment of a particular tax affecting their cash flow. Care, of course, must be exercised in implying unambiguous causality in the reported results. We do this through the use of logistic regression techniques (or Logit Model) applied independently for VAT, PAYE/ENICs, Personal Tax and Corporation Tax. The chapter is organised around each of these four taxes and the models reported separately. The precise nature of the logistic regression technique is set out in the first section on VAT. The chapter concludes with a summary of the results across each of the four tax areas.

6.2 Payment of VAT and Cash Flow Problems: A Multivariate Analysis

As we have seen the survey asked questions on the extent to which the payment of VAT has been a problem for cash flow in the business. Respondents were asked to indicate in broad terms whether this had been a 'critical, 'major', 'minor' or 'no problem'. Many social phenomena are discrete rather than continuous in nature. In other words an event occurs or it does not occur. In this study, the variables on whether the payment of VAT has posed a problem for cash flow fall into the category of discrete or qualitative information – it has posed a 'critical' or 'major' problem or it did not. One of the most commonly used and appropriate methods for estimating models with two outcomes, when the dependent variable associated with the outcome is discrete, is logistic regression[9].

The section begins with a discussion of the dependent and independent variables used in the multivariate analysis for each of the taxes under review: VAT, PAYE/ENICs, Personal Tax and Corporation Tax. This is followed by a section estimating models which seek to explain the likelihood of a business reporting that they view the payment of VAT as a critical or major problem for their business using a basic set of business characteristics – size, age, sector and legal structure (structural variables), together with a range of contextual variables – for example, growth, owner-manager characteristics, nature of VAT payment system adopted, pattern of annual sales and the extent to which the business is cash-based or invoice-based. In all cases the modelling approach adopted will be from the general

[9] In estimating the coefficients of Logistic Regression, the maximum likelihood procedure is used. Interpreting Logistic regression or Logit output in terms of odds rather than probabilities confers certain advantages. Most important among these is that exp (β) is a single summary statistic for the partial effect of a given predictor on the odds, controlling for other predictors in the model. The Logit is simply the log of the odds of being in one category versus another of the dependent variable – in this case whether they reported that the payment of VAT was a 'critical' or 'major' problem for the cash flow of the business or not.

to the specific with the aim to estimate general models including all variables and then to proceed to present parsed models which have the most explanatory power. It is these latter models which are reported here.

6.2.1 Dependent and Independent Variables

We use one dependent variable in the logistic regression models of the extent to which VAT payment is a problem for the cash flow of the business. The dependent variable in the logistic regression model is a dichotomous one. It takes the value of "1" if the respondent indicated that they viewed the payment of VAT as a 'critical' or 'major' problem for the cash flow of the business and "0" otherwise. For the purposes of analysis, the response categories of the extent of the problem have been collapsed into one category taking the value of "1".[10] Overall, just over one-fifth (22.5%) of respondents (unweighted) reported that the payment of VAT was a 'critical' or 'major' problem for the cash flow of their business.

The determining variables for estimating the dichotomous Logit model are set out in Tables 6.1 and 6.2. What we are seeking to do in the Logit model is to isolate those factors which independently have an impact on a business reporting a problem with the payment of VAT on the cash flow of the business. Table 6.1 defines those variables which we call 'structural variables' in the analysis in that they represent the characteristics of the firm and include size, sector, age and legal status.

[10] Ordered Probit and Multinomial Logit modelling are alternative approaches given the 4 categories of responses in the original question. They have been investigated but produce weaker models than those reported here adopting a dichotomous logistic regression approach.

Table 6.1

Definition of Structural Variables used in the Logistic Regression	
Variable Name	**Definition**
Size of Business	
Employment	
Micro	1=1-4 employees; 0=not
Vsmall	1=5-10 employees; 0=not
Small	1=10-19 employees; 0=not
Medium	1=20-49 employees; 0=not
Turnover	
NonVAT	1=<£58k; 0=not
Turn1	1=£58-149k; 0=not
Turn2	1=£150-249k; 0=not
Turn3	1=£250-659k; 0=not
Turn4	1=£660-1.5million; 0=not
Age of Business	
Age1	1=set up pre-1990; 0=not
Age2	1=set up in 1990-94; 0=not
Age3	1=set up in 1995-99; 0=not
Age4	1=set up since 1999; 0=not
Legal Status	
SProp	1=Sole Proprietor; 0=not
Partner	1=Partnership; 0=not
Limited	1=Private limited company; 0=not
Other	1=Other legal status; 0=not
Sector	
Primary	1=Primary; 0=not
Manuf	1=Manufacturing; 0=not
Cons	1=Construction; 0=not
Consum	1=Consumer Services; 0=not
Fbpserv	1=Financial, Business and Personal Services; 0=not

Source: All variables derived from the SBRC HMRC Survey 2005

In addition to these structural variables a further set of contextual variables were included in the multivariate analysis to provide further insights into the key determinants of a respondent reporting a problem with the payment of VAT on cash flow. The range of variable selected include growth in the previous 12 months, owner-manager characteristics, nature of VAT payment system adopted, difficulties in meeting HMRC deadlines, pattern of annual sales and the extent to which the business is cash-based or invoice-based (Table 6.2).

Table 6.2:

Definition of Contextual Variables used in the Logistic Regression	
Variable	Definition
Financial Characteristics of the Business: Sales and Purchases	
Cash Purchases	% of Purchases Cash
Credit/Invoice Purchases	% of Purchases Credit/Invoices
Cash Sales	% of Sales Income Cash
Credit/Invoice Sales	% of Sales Income Credit/Invoice
Variable and Unpredictable Sales Income	1=Yes; 0=not
Late payment a problem	1=Critical of Major problem; 0=not
Bad debt a problem	1=Critical of Major problem; 0=not
Method of Payment of VAT	
Any Electronic VAT Payments	1=use electronic means to pay VAT; 0=not
VAT paid quarterly on invoices issued	1=use; 0=not use
Annual Accounting Scheme	1=use; 0=not use
Cash Accounting Scheme	1=use; 0=not use
Flat Rate Scheme	1=use; 0=not use
Retail Point of Sale Scheme	1=use; 0=not use
Retail Apportionment Scheme	1=use; 0=not use
Retail Direct Calculation Scheme	1=use; 0=not use
VAT paid monthly	1=use; 0=not use
VAT paid by cheque	1=use; 0=not use
HMRC Deadlines	
HMRC deadline in last two years	1=yes; 0=no
VAT deadline difficulty	1=yes; 0=no
Corporation Tax deadline difficulty	1=yes; 0=no
PAYE/ENICs deadline difficulty	1=yes; 0=no
Personal Tax deadline difficulty	1=yes; 0=no
Financial Advice	
Accountants	1=employs an in-house professionally qualified accountant; 0=not
Book-keeper	1=employs an in-house dedicated book-keeper or someone other than a professionally qualified accountant; 0=not
Business Performance	
Employment Growth in previous 12 months	1=Yes; 0=not
Turnover Growth in previous 12 months	1=Yes; 0=not
Profit Growth in previous 12 months	1=Yes; 0=not
Owner-Manager Characteristics	
Owner-Manager education level	1=degree or higher; 0=not
Owner-Manager has a finance qualification	1=Finance qualification; 0=not
Ethnicity of Owner-Manager	1=EMB; 0=not

Source: All variables derived from the SBRC HMRC Survey 2005

6.2.2 Factors Influencing VAT Payment Problems for Cash Flow

This section sets out the results of the estimated logistic regression models. This is done in two steps: first with only the structural variables included and then with the contextual variables added. The odds ratio associated with each coefficient in the estimated models will be presented[11]. An odds ratio greater than 1 indicates that the odds of a business reporting a problem increases when the independent variable (e.g., size or age) increases. An odds ratio of less than 1 indicates that the odds of a business reporting a problem decreases when the independent variable increases, while estimates close to 1 indicate no effect on the odds. In this instance, the focus is on estimating the log odds of a business reporting a problem given the set of determining variables indicated in Tables 6.1 and 6.2.

Model 1: Structural Variables

The general model for VAT payment and cash flow was first estimated using only the set of structural variables. Table 6.3 presents the Logit model for reported problems using the original full set of explanatory structural variables[12]. It should be noted that the number of observations for this model (n=750)[13] was less than the total number of respondents in the survey. This was a result of constraining the number of observations to those that were registered for VAT.

[11] The odds ratio is a multiplicative coefficient which means that "positive" effects are greater than 1 while "negative" effects lie between 0 and 1. The odds ratio is the number by which one would multiply the odds of a respondent reporting that the payment of VAT was a problem for the cash flow of their business for each one unit increase in the independent variable.

[12] The Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is significant which leads us to reject the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

[13] Throughout this section the analysis was performed on the unweighted dataset.

Structural Variables

The model shows that the probability of a respondent reporting that VAT payment was a 'critical' or 'major' problem for their business is associated with:

- **Size:**
    - businesses employing less than 5 employees were significantly less likely (the odds ratio of 0.34 implies that they are 34 per cent as likely) than those employing 20-49 employees (the reference category) to report an increase a cash flow problem as a result of VAT payments. The sign was negative and significant.
    - the signs for the remaining two employment size bands (5-9 and 10-19) were also negative but neither of the variables were significant.
    - this finding is confirmed by the turnover size bands which show that it is the 'medium sized' small businesses (£150-249k and £250-659k) who are more likely (approximately 1.5 times more likely) to report a problem of cash flow caused by VAT payment compared to those businesses with a turnover of £660k or more (the reference category). Both of these variables are positive and marginally insignificant.
- **Age:**
    - all of the age variables were negative compared to the reference category (set up since 1999) but not significant.
- **Sector:**
    - businesses engaged in Construction as well as those in the Financial, Business and personal Services were significantly more likely (2-3 times more likely with odds ratios of 2.31 and 3.03 respectively) to report that VAT payment was a problem for cash flow compared to those in Primary activities (the reference category). Manufacturing businesses are also more likely but this variable is very marginally non-significant

- **Legal Status:**
    - sole proprietors were significantly more likely (1.8 times more likely: odds ratio 1.79) than Limited companies (the reference category) to report that the payment of VAT was causing a cash flow problem in their business.

The key findings, therefore, are that the probability of a business reporting cash flow problems as a result of VAT payments are related to size, sector and legal status: 'mid-size' small businesses, legally set up as sole proprietorships and operating in Construction and Financial, Business and Personal Services (and to a lesser extent Manufacturing) were more likely to report cash flow problems.

Table 6.3

Dichotomous Logistic Regression for VAT Payment and Cash Flow: Base Model

Dependent Variable: VAT payments a 'critical' or 'major' problem for cash flow

Number of observations = 750
Wald $\chi^2(16)$ = 36.65
Prob > χ^2 = 0.0024
Log Likelihood = -381.70 Pseudo R^2=0.0462
Percentage Correct Predictions: 77.6%

Independent Variables	Odds Ratio	Std. Err.	Z	P>z
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	0.34	.1386393	-2.65***	0.008
Vsmall (5-9 emps)	0.89	.3042621	-0.35	0.725
Small (10-19 emps)	0.76	.2670205	-0.79	0.431
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	1.22	.569399	0.42	0.672
Turn1 (£58-149k)	0.93	.2902573	-0.25	0.805
Turn2 (£150-249k)	1.59	.4660697	1.57	0.116
Turn3 (£250-659k)	1.49	.3725251	1.60	0.109
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	0.82	.2241969	-0.71	0.476
Age2 (1980-89)	0.80	.2094693	-0.86	0.387
Age3 (1990-99)	0.99	.2354028	-0.05	0.960
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	1.74	.9012585	1.07	0.286
Construction	3.03	1.613709	2.08**	0.038
Manufacturing	3.52	1.176032	1.64	0.101
Financial, Business and Personal Services	2.31	1.876824	2.36**	0.019
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)	1.79	.4373891	2.38**	0.017
Partnerships	1.07	.2713257	0.28	0.780

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*

Model 2: Structural and Contextual Variables

Table 6.4 presents the parsed Logit model for reported cash flow problems caused by VAT payments using the original full set of explanatory structural variables together with selected contextual variables[14].

Table 6.4

Dichotomous Logistic Regression for VAT Payment and Cash Flow: Contextual Model				
Dependent Variable: VAT payments a 'critical' or 'major' problem for cash flow				
Number of observations = 750 **Wald $\chi^2(25)$ = 130.67** **Prob > χ^2 = 0.0000** **Log Likelihood = -327.11377 Pseudo R^2=0.1826** **Percentage Correct Predictions: 78.5%**				
Independent Variables	**Odds Ratio**	**Std. Err.**	**Z**	**P>z**
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	0.47	.2159882	-1.65*	0.100
Vsmall (5-9 emps)	1.06	.3922358	0.15	0.880
Small (10-19 emps)	0.86	.3341835	-0.38	0.695
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	1.44	.7471949	0.70	0.484
Turn1 (£58-149k)	1.00	.3565096	0.00	0.997
Turn2 (£150-249k)	1.45	.453173	1.19	0.234
Turn3 (£250-659k)	1.68	.4593381	1.91*	0.056
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	0.90	.273005	-0.34	0.734
Age2 (1980-89)	0.92	.2786156	-0.27	0.787
Age3 (1990-99)	1.08	.2824052	0.31	0.760
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	1.78	.922213	1.11	0.267
Construction	2.45	1.304327	1.69*	0.092
Manufacturing	3.02	1.587375	2.10**	0.036
Financial, Business and Personal Services	2.41	1.215796	1.75*	0.081
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)	2.02	.5592793	2.53**	0.011
Partnerships	1.19	.336585	0.61	0.545
Contextual Variables				
% of Sales Income Cash	1.00	.0014963	1.78*	0.074
% of Sales Income Credit/Invoices	1.00	.0014885	-1.80*	0.072
Any Electronic VAT Payments	1.82	.4699822	2.30**	0.021
Variable Sales Income which is unpredictable	1.45	.3006972	1.81*	0.071
Owner-Manager has degree or higher	0.73	.1679114	-1.36	0.173
Late payment a Critical or Major Problem	4.95	1.103807	7.16***	0.000
Employment Growth in previous 12 months	0.62	.1491452	-2.00**	0.046
Turnover Growth in previous 12 months	1.28	.2586595	1.24	0.215
Profit Growth in previous 12 months	0.42	.0912932	-4.00***	0.000

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*

[14] The Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is significant which leads us to reject the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

In this model the structural variables that were positive and significant were three sector dummies (i.e., Construction, Manufacturing, and Financial, Business and Personal Services – odds ratios of 2.41 to 3.02), size (turnover in the range £250-659k – odds ratio 1.68) and sole proprietorships (odds ratio 2.02) – therefore, businesses in these categories were significantly more likely to report that VAT payments had caused a problem ('critical' or 'major') for the cash flow of the business. The variable for the very smallest business in employment terms (less than 5 employees) was negative and significantly associated with reporting a problem – in other words businesses in this size band were significantly less likely (around half as likely – odds ratio 0.47) to report a problem.

More interestingly, a number of the contextual variables proved to be significant. On the one hand there were a number of variables that were positively associated[15] with the business reporting a cash flow problem:

- Sales: the higher the percentage of sales income generated through cash, the greater the likelihood that the business reported that VAT payments caused a problem with cash flow.

- Sales: businesses with a variable and unpredictable sales profile were much more likely to report a problem with respect to VAT payments on cash flow (odds ratio 1.45).

- Sales: businesses who reported 'late payment' as a critical or major problem were also significantly more likely (5 times more likely – odds ratio 4.95) to report that VAT payment created a cash flow problem for the business.

[15] It must be stressed that no clear inference about the direction of causality can be determined from the reported results.

- VAT Payment Method: businesses paying VAT using electronic means were much more likely (odds ratio 1.8) to report that VAT payment created a cash flow problem.

- Growth: businesses that had increased turnover in the previous 12 months were more likely to report VAT payments created a cash flow problem. However, the variable was positive but not significant.

On the other hand the following variables were negatively associated with cash flow problems:

- Sales: the higher the percentage of sales income generated through credit or invoices, the likelihood that the business reported that VAT payments caused a problem with cash flow was reduced

- Growth: businesses reporting a profit or increased employment in the previous 12 months were also significantly less likely (odds ratios 0.42 and 0.62 respectively) to report a cash flow problem.

- Owner-Manager Characteristics: owner-managers educated at degree level or above were less likely (odds ratio 0.73) to report VAT payments posed a cash flow problem for the business, but the variable was not significant.

6.3 Payment of PAYE/ENICs and Cash Flow Problems: A Multivariate Analysis

6.3.1 Dependent and Independent Variables

We use one dependent variable in the logistic regression models of the extent to which the payment of PAYE/ENICs creates a cash flow problem for the business. The dependent variable in the logistic regression model is a dichotomous one. It takes the value of "1" if the respondent indicated that they viewed the payment of PAYE/ENICs as a 'critical' or 'major' problem for the cash flow of the business and "0" otherwise. For the purposes of analysis, the response categories of the extent of the problem have been collapsed into one category taking the value of "1".[16] The determining variables for estimating the dichotomous Logit model were set out in Tables 6.1 and 6.2. Overall, 13.3 per cent of respondents (unweighted) reported that the payment of PAYE/ENICs was a 'critical' or 'major' problem for the cash flow of their business.

6.3.2 Factors Influencing PAYE/ENICs Payment Problems for Cash Flow

This section sets out the results of the estimated logistic regression models. This is done in two steps: first with only the structural variables included and then with the contextual variables added.

[16] Ordered Probit and Multinomial Logit modelling are alternative approaches given the 4 categories of responses in the original question. They have been investigated but produce weaker models than those reported here adopting a dichotomous Logit model approach.

Model 1: Structural Variables

The general model for PAYE/ENICs payment and cash flow was first estimated using only the set of structural variables (Table 6.5)[17]. It should be noted that the number of observations for this model (n=634) was less than the total number of respondents in the survey. This was a result of constraining the number of observations to those who reported that they paid PAYE and /or ENICs for their staff.

Table 6.5:

Dichotomous Logistic Regression for PAYE/ENICs Payment and Cash Flow: Base Model

Dependent Variable: PAYE/ENICs payments a 'critical' or 'major' problem for cash flow

Number of observations = 634
Wald $\chi^2(16)$ = 21.00
Prob > χ^2 = 0.1786
Log Likelihood = -240.48778 Pseudo R^2=0.0445
Percentage Correct Predictions: 86.4%

Independent Variables	Odds Ratio	Std. Err.	Z	P>z
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	0.42	.2283311	-1.60	0.110
Vsmall (5-9 emps)	0.73	.3209575	-0.73	0.468
Small (10-19 emps)	0.91	.3944667	-0.23	0.820
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	1.60	1.294794	0.59	0.558
Turn1 (£58-149k)	1.26	.5443194	0.54	0.586
Turn2 (£150-249k)	2.78	1.034688	2.75***	0.006
Turn3 (£250-659k)	1.47	.488828	1.17	0.242
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	0.75	.2695542	-0.80	0.425
Age2 (1980-89)	0.96	.3244834	-0.13	0.893
Age3 (1990-99)	0.76	.2468593	-0.85	0.395
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	0.76	.5161198	-0.40	0.688
Construction	1.69	1.164858	0.76	0.444
Manufacturing	0.92	.654637	-0.12	0.902
Financial, Business and Personal Services	1.12	.7350716	0.17	0.868
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)	1.02	.3435883	0.06	0.950
Partnerships	0.54	.2022126	-1.65*	0.098

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*

[17] The Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is not significant which leads us to accept the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

Model 2: Structural and Contextual Variables

Table 6.6 presents the parsed Logit model for reported cash flow problems caused by PAYE/ENICs payments using the original full set of explanatory structural variables together with selected contextual variables[18].

Table 6.6

Dichotomous Logistic Regression for PAYE/ENICs Payment and Cash Flow: Contextual Model

Dependent Variable: PAYE/ENICs payments a 'critical' or 'major' problem for cash flow

Number of observations = 634
Wald $\chi^2(19)$ = 80.00
Prob > χ^2 = 0.0000
Log Likelihood = -209.3098 Pseudo R^2=0.1684
Percentage Correct Predictions: 86.8%

Independent Variables	Odds Ratio	Std. Err.	Z	P>z
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	0.65	.3776097	-0.73	0.462
Vsmall (5-9 emps)	0.97	.4359305	-0.07	0.944
Small (10-19 emps)	1.27	.5821819	0.52	0.600
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	1.40	1.25976	0.38	0.707
Turn1 (£58-149k)	1.52	.7085559	0.89	0.372
Turn2 (£150-249k)	2.50	.9990353	2.30**	0.022
Turn3 (£250-659k)	1.46	.5078691	1.08	0.282
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	1.01	.4013872	0.02	0.987
Age2 (1980-89)	1.25	.468666	0.58	0.559
Age3 (1990-99)	0.89	.3162951	-0.32	0.753
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	1.08	.7748842	0.11	0.914
Construction	2.13	1.58185	1.01	0.310
Manufacturing	0.98	.7345544	-0.03	0.974
Financial, Business and Personal Services	1.38	.964891	0.46	0.643
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)	1.22	.4388471	0.54	0.589
Partnerships	0.58	.2300514	-1.37	0.171
Contextual Variables				
Profit Growth in previous 12 months	0.39	.1085551	-3.38***	0.001
Late payment a Critical or Major Problem	5.25	1.515818	5.74***	0.000
Owner-Manager is a member of and Ethnic Minority Group	2.73	1.368695	2.00**	0.046

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*

In this model, the only structural variable that was significant was turnover size (£150-249k), indicating that, controlling for other variables, larger small businesses

[18] The Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is significant on this occasion which leads us to reject the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

were more likely to report (two and half times more likely –odds ratio 2.5) the payment of PAYE/ENICs as a cash flow problem in their business.

More interestingly, three of the contextual variables proved to be significant in the model reported here. On the one hand there were two variables that were positively associated with the business reporting a cash flow problem:

- Sales: businesses reporting 'late payment' as a critical or major problem for their business were also significantly more likely (5 times more likely –odds ratio 5.25) to report that PAYE/ENICs payments created a cash flow problem.

- Owner-Manager Characteristics (Ethnicity): businesses whose owner-manager was a member of an ethnic minority group were more likely to report a cash flow problem with PAYE/ENICs payments (odds ratio 2.73).

On the other hand, one variable was negatively and significantly associated with cash flow problems:

- Growth: businesses who had made a profit in the previous 12 months were significantly less likely (odds ratio 0.39) to report a cash flow problem as a result of PAYE/ENICs payments.

6.4 Payment of Personal Tax and Cash Flow Problems: A Multivariate Analysis

6.4.1 Dependent and Independent Variables

We use one dependent variable in the logistic regression models of the extent to which the payment of Personal Tax crates a cash flow problem for the business. The dependent variable in the logistic regression model is a dichotomous one. It takes the value of "1" if the respondent indicated that they viewed the payment of Personal Tax as a 'critical' or 'major' problem for the cash flow of the business and "0" otherwise. For the purposes of analysis, the response categories of the extent of the problem have been collapsed into one category taking the value of "1".[19] The determining variables for estimating the dichotomous Logit model were set out in Tables 6.1 and 6.2. Overall, 14.7 per cent of respondents (unweighted) reported the payment of Personal Tax as a 'critical' or 'major' problem for business cash flow.

6.4.2 Factors Influencing Personal Tax Payment Problems for Cash Flow

This section sets out the results of the estimated logistic regression models. This is done in two steps: first with only the structural variables included and then with the contextual variables added.

[19] Ordered Probit and Multinomial Logit modelling are alternative approaches given the 4 categories of responses in the original question. They have been investigated but produce weaker models than those reported here adopting a dichotomous logit model approach.

Model 1: Structural Variables

The general model for Personal Tax payment and cash flow was first estimated using only the set of structural variables (Table 6.7).[20] All respondents were included in the model. Businesses with a turnover between £150-249k and £250-659k – odds ratios 1.91 and 1.97 respectively) were more likely to report problems with the payment of Personal Tax than businesses with a turnover in excess of £660k. Similarly, businesses in Financial and Business Services (odds ratio 3.26) as well as Sole Proprietorships and Partnerships were more likely to report problems (odds ratios 2.85 and 2.40 respectively).

[20] The Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is significant which leads us to reject the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

Table 6.7

Dichotomous Logistic Regression for Personal Tax Payment and Cash Flow: Base Model				
Dependent Variable: Personal Tax payments a 'critical' or 'major' problem for cash flow				
Number of observations = 875 **Wald $\chi^2(16)$ = 44.21** **Prob > χ^2 = 0.0002** **Log Likelihood = -338.57606 Pseudo R^2=0.0612** **Percentage Correct Predictions: 85.6%**				
Independent Variables	**Odds Ratio**	**Std. Err.**	**Z**	**P>z**
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	1.20	.639552	0.35	0.728
Vsmall (5-9 emps)	1.55	.776482	0.87	0.328
Small (10-19 emps)	1.48	.7532178	0.77	0.442
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	0.97	.4161713	-0.08	0.937
Turn1 (£58-149k)	0.99	.3714512	-0.03	0.977
Turn2 (£150-249k)	1.91	.6684743	1.86*	0.063
Turn3 (£250-659k)	1.97	.5827618	2.02*	0.044
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	1.00	.2913418	-0.01	0.992
Age2 (1980-89)	1.25	.3400745	0.83	0.404
Age3 (1990-99)	0.72	.1935782	-1.24	0.215
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	2.05	1.11889	1.31	0.190
Construction	2.26	1.320065	1.40	0.163
Manufacturing	2.17	1.284852	1.30	0.193
Financial, Business and Personal Services	3.26	1.76085	2.19*	0.029
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)	2.85	.7700941	3.87***	0.000
Partnerships	2.40	.6526666	3.22***	0.001

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*

Model 2: Structural and Contextual Variables

Table 6.8 presents the parsed Logit model for reported cash flow problems caused by Personal Tax payments using the original full set of explanatory structural variables together with selected contextual variables[21].

[21] The Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is significant on this occasion which leads us to reject the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

Table 6.8

Dichotomous Logistic Regression for Personal Tax Payment and Cash Flow: Contextual Model

Dependent Variable: Personal Tax payments a 'critical' or 'major' problem for cash flow

Number of observations = 875
Wald $\chi^2(22)$ = 95.58
Prob > χ^2 = 0.0000
Log Likelihood = -306.53246 Pseudo R^2=0.1500
Percentage Correct Predictions: 86.3%

Independent Variables	Odds Ratio	Std. Err.	Z	P>z
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	1.99	1.13884	1.21	0.228
Vsmall (5-9 emps)	1.98	1.069359	1.27	0.225
Small (10-19 emps)	1.62	.8857334	0.88	0.377
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	0.82	.3598206	-0.45	0.654
Turn1 (£58-149k)	1.00	.4000336	0.00	0.999
Turn2 (£150-249k)	1.65	.6085081	1.35	0.176
Turn3 (£250-659k)	1.86	.6103081	1.89*	0.059
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	1.33	.4155737	0.93	0.355
Age2 (1980-89)	1.64	.4858012	1.67*	0.095
Age3 (1990-99)	0.76	.2258691	-0.92	0.358
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	2.85	1.626708	1.84*	0.066
Construction	2.40	1.488183	1.41	0.158
Manufacturing	2.03	1.282222	1.12	0.262
Financial, Business and Personal Services	3.77	2.146231	2.33**	0.020
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)	3.48	1.034683	4.20***	0.000
Partnerships	2.92	.8233938	3.81***	0.000
Contextual Variables				
Turnover Growth in previous 12 months	0.79	.1786492	-1.05	0.295
Profit Growth in previous 12 months	0.61	.1422493	-2.12**	0.034
Late payment a Critical or Major Problem	2.48	.6474049	3.48***	0.001
Bad Debt a Critical or Major Problem	2.23	.6538044	2.73**	0.006
Variable Sales Income which is unpredictable	1.77	.3876407	2.61**	0.009
Owner-Manager has a degree or higher	1.56	.356605	1.94*	0.053

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*

In this model, several structural variables were significantly and positively associated with reporting cash flow problems related to Personal Tax payments. Businesses with a turnover of £250-659k (odds ratio 1.86) as well as those set up in the 1980s (odds ratio 1.64) were more likely to report that they had experienced cash flow problems associated with these tax payments. Two of the sector dummies were positive and significant – Consumer Services (odds ratio 2.85) and Financial, Business and Personal Services (odds ratio 3.77). The Construction dummy was positive but not significant in the model. Finally, sole proprietorships (including the

self-employed) or partnerships were significantly more likely to report that Personal Tax payments had caused a cash flow problem in the business (odds ratios 3.48 and 2.92 respectively).

More interestingly, three of the contextual variables proved to be significant in the model reported here. On the one hand there were two variables that were positively associated with the business reporting a cash flow problem:

- Sales: businesses who reported that 'late payment' was a critical or major problem for their business were also significantly more likely (two and half times – odds ratio 2.48) to report that their Personal Tax payments created a cash flow problem for the business.

- Sales: businesses who reported that 'bad debt' was a critical or major problem for their business were also significantly more likely (almost two and half times –odds ratio 2.23) to report that their Personal Tax payments created a cash flow problem for the business.

- Sales: those businesses with a variable and unpredictable sales profile were much more likely to report a problem with respect to Personal Tax payments on cash flow (odds ratio 1.77).

- Owner-Manager Characteristics (Degree): owner-managers educated at degree level or above were more likely (odds ratio 1.56) to report Personal Tax payments posed a cash flow problem for the business (this was the opposite sign to that observed in the VAT model)

On the other hand, one variable was negatively and significantly associated with cash flow problems:

- Growth: businesses reporting a profit in the previous 12 months were significantly less likely (odds ratio 0.61) to report a cash flow problem as a result of Personal Tax payments. The sign for turnover growth was also negative but not significant.

6.5 Payment of Corporation Tax and Cash Flow Problems: A Multivariate Analysis

6.5.1 Dependent and Independent Variables

We use one dependent variable in the logistic regression models of the extent to which the payment of Corporation Tax is a problem for the cash flow of the business. The dependent variable in the logistic regression model is a dichotomous one. It takes the value of "1" if the respondent indicated that they viewed the payment of Corporation Tax as a 'critical' or 'major' problem for the cash flow of the business and "0" otherwise. For the purposes of analysis the response categories of the extent of the problem have been collapsed into one category taking the value of "1".[22] The determining variables for estimating the dichotomous Logit model were set out in Tables 6.1 and 6.2. Overall, 19.9 per cent of respondents (unweighted) reported that the payment of Corporation Tax was a 'critical' or 'major' problem for the cash flow of their business.

[22] Ordered Probit and Multinomial Logit modelling are alternative approaches given the 4 categories of responses in the original question. They have been investigated but produce weaker models than those reported here adopting a dichotomous logit model approach.

6.5.2 Factors Influencing Corporation Tax Payment Problems for Cash Flow

This section sets out the results of the estimated logistic regression models. This is done in two steps: first with only the structural variables included and then with the contextual variables added.

Model 1: Structural Variables

The general model for Corporation Tax payments and cash flow was first estimated using only the set of structural variables (Table 6.9)[23]. It should be noted that the number of observations for this model (n=347) was less than the total number of respondents in the survey. This was a result of constraining the number of observations to those that reported that they were eligible to pay Corporation Tax.

[23] The Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is not significant which leads us to accept the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

Table 6.9

Dichotomous Logistic Regression for Corporation Tax Payment and Cash Flow: Base Model

Dependent Variable: Corporation Tax payments a 'critical' or 'major' problem for cash flow

Number of observations = 347
Wald $\chi^2(14)$ = 18.64
Prob > χ^2 = 0.1790
Log Likelihood = -163.30454 Pseudo R^2=0.0488
Percentage Correct Predictions: 80.4%

Independent Variables	Odds Ratio	Std. Err.	Z	P>z
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	0.76	.5352518	-0.39	0.696
Vsmall (5-9 emps)	2.33	1.212445	1.62	0.105
Small (10-19 emps)	1.50	.7929386	0.77	0.442
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	0.63	.7117304	-0.41	0.685
Turn1 (£58-149k)	0.88	.4211212	-0.27	0.785
Turn2 (£150-249k)	1.63	.7537292	1.06	0.291
Turn3 (£250-659k)	1.00	.3483596	0.01	0.990
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	0.74	.3155553	-0.71	0.478
Age2 (1980-89)	0.50	.2172747	-1.60	0.111
Age3 (1990-99)	0.66	.2338206	-1.17	0.243
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	0.42	.30848	-1.18	0.238
Construction	0.64	.4695103	-0.61	0.543
Manufacturing	0.89	.6478282	-0.15	0.881
Financial, Business and Personal Services	0.68	.4704554	-0.56	0.576
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)[1]	-	-	-	-
Partnerships[1]	-	-	-	-

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*
[1] Variables dropped due to collinearity which is consistent with the model being constrained for only those businesses eligible for Corporation Tax.

Model 2: Structural and Contextual Variables

Table 6.10 presents the parsed Logit model for reported cash flow problems caused by Corporation Tax payments using the original full set of explanatory structural variables together with selected contextual variables. On this occasion the Wald χ^2 statistic for the joint impact of all the explanatory variables on the dependent variable is significant which leads us to reject the null hypothesis that the model did not have greater explanatory power than a 'constant term only' model.

Table 6.10

Dichotomous Logistic Regression for Corporation Tax Payment and Cash Flow: Contextual Model

Dependent Variable: Corporation Tax payments a 'critical' or 'major' problem for cash flow

Number of observations = 347
Wald $\chi^2(19)$ = 48.10
Prob > χ^2 = 0.0002
Log Likelihood = -141.94748 Pseudo R^2=0.1732
Percentage Correct Predictions: 80.1%

Independent Variables	Odds Ratio	Std. Err.	Z	P>z
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro (1-4 emps)	1.23	.979016	0.27	0.791
Vsmall (5-9 emps)	2.46	1.408293	1.58	0.115
Small (10-19 emps)	1.73	.989814	0.96	0.335
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT (<£58k)	0.31	.3361457	-1.08	0.280
Turn1 (£58-149k)	0.69	.403606	-0.63	0.529
Turn2 (£150-249k)	1.28	.6050513	0.53	0.595
Turn3 (£250-659k)	0.92	.3516311	-0.23	0.820
Age of Establishment (reference category Age 4 – post-1999)				
Age1 (Pre-1980)	0.58	.2772701	-1.14	0.255
Age2 (1980-89)	0.49	.2357195	-1.48	0.140
Age3 (1990-99)	0.65	.2481929	-1.12	0.261
Sector (reference category Primary)				
Consumer Services (Hotels and Rest; Retail, W'Sale)	0.36	.2712236	-1.36	0.175
Construction	0.54	.415836	-0.80	0.424
Manufacturing	1.00	.7462983	0.00	0.999
Financial, Business and Personal Services	0.82	.5709339	-0.29	0.771
Legal Status (reference category Limited)				
Sole Proprietorships (including the self-employed)	-	-	-	-
Partnerships	-	-	-	-
Contextual Variables				
Employment Growth in previous 12 months	0.60	.2345265	-1.32	0.188
Late payment a Critical or Major Problem	5.96	2.019448	5.27***	0.000
Variable Sales Income which is unpredictable	1.74	.5265801	1.83*	0.067
% of Sales Income Cash	1.00	.002602	2.06**	0.039
% of Sales Income Credit/Invoices	1.00	.0025756	-2.06**	0.040

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*
[1] Variables dropped due to collinearity which is consistent with the model being constrained for only those businesses eligible for Corporation Tax.

In this model, none of the structural variables was significant. However, a number of the contextual variables proved to be significant. On one hand, three variables were positively associated with the business reporting a cash flow problem as a result of Corporation Tax payments:

- Sales: the higher the percentage of sales income generated through cash the greater the likelihood that the business reported that Corporation Tax payments caused a problem with cash flow.

- Sales: businesses with a variable and unpredictable sales profile were much more likely to report a problem with respect to Corporation Tax payments on cash flow (odds ratio 1.74).

- Sales: businesses reporting 'late payment' as a critical or major problem were significantly more likely (5 times more likely –odds ratio 5.95) to report that Corporation Tax payments created a cash flow problem for the business.

On the other hand, two variables were negatively and significantly associated with cash flow problems:

- Growth: businesses increasing employment in the previous 12 months were less likely (odds ratio 0.60) to report a cash flow problem as a result of Corporation Tax payments – although the variable was not significant..

- Sales: the higher the percentage of sales income generated through credit or invoices the likelihood that the business reported that Corporation Tax payments caused a problem with cash flow was reduced.

Overall, there are broad similarities between this Corporation Tax model and the model for VAT payments reported earlier, in that, although none of the structural variables are significant, there is a set of variables common to both models. These are the way sales income is generated and the problem of customers late payment.

6.6 Summary

The results of the multivariate analyses conducted for each of the four tax payments are summarised in Table 6.11. The importance of controlling responses for business size, sector, age and legal status is clearly illustrated.

Overall, it is possible to draw the following conclusions:

- It is not the *very* smallest firms who are experiencing taxation payment problems;
- There are *sectoral effects* independent of size and age;
- Sole proprietorships and partnerships are more likely to report that tax payments create cash flow problems;

Having controlled for a set of business characteristics (size, sector, age and legal status), the following emerge as independent influences on the likelihood of a business to report cash flow problems associated with tax payments. However, as noted earlier care still needs to be taken about the direction of causality in these models.

- How sales are generated are an important indicator of potential cash flow problems – especially with respect to VAT and Corporation Tax
- Variability and unpredictability of sales are important factors in understanding why businesses report that tax payments pose cash flow problems
- Late payment is a crucial factor in determining the probability of a business to report cash flow problems in all four models
- Generally, growing businesses are not associated with problems with tax payments on their cash flow – except turnover growth for VAT but this is weak (not significant).

- Paying VAT by electronic means would appear to be associated with an increased likelihood of a business reporting a negative impact of the tax payment on the cash flow of the business.

Table 6.11:

Summary of Significant Logistic Regression Results for the Extent of the Problem on the Payment of VAT; Corporation Tax, Personal Tax and PAYE

	Dependent Variables			
Independent Variables	**VAT**	**PAYE/ENICs**	**Personal Tax**	**Corporation Tax**
Size of Business: Employment (reference category medium (20-49 emps.)				
Micro	-ve*			
Vsmall				
Small				
Size of Business: Turnover (reference category Turn4 (£660-1.5million)				
NonVAT				
Turn1				
Turn2		+ve**		
Turn3	+ve*		+ve*	
Age of Establishment (reference category Age 4)				
Age1				
Age2			+ve*	
Age3				
Sector (reference category Primary)				
Consum			+ve*	
Const	+ve*			
Manuf	+ve**			
FBPServ	+ve*		+ve**	
Legal Status (reference category Limited)				
SProp	+ve**		+ve***	-
Partner			+ve***	-
Contextual Variables				
% of Sales Income Cash (q4a)	+ve*			+ve*
% of Sales Income Credit/Invoices (q4b)	-ve*			-ve*
Any Electronic VAT Payments (q2902)	+ve**			
Variable Sales Income which is unpredictable (q41 & q42)	+ve*		+ve**	+ve*
Owner-Manager has degree or higher	-ve		+ve*	
Owner-Manger – Ethnic Minority Group		+ve***		
Late payment a Critical or Major Problem (q6)	+ve***	+ve***	+ve***	+ve***
Bad Debt a Critical or Major Problem			+ve**	
Employment Growth in previous 12 months	-ve**			-ve
Turnover Growth in previous 12 months	+ve			
Profit Growth in previous 12 months (q45)	-ve***	-ve***	-ve***	

Source: SBRC HMRC Business Survey, 2005
*Notes: * denotes significance at the 0.10 level; ** denotes significance at the 0.05 level; *** denotes significance at the 0.01 level.*

Chapter 7: Summary and Conclusions

7.1 Background

This Report has presented new evidence on the methods and the effects of the timing of taxation payments on the cash flow of small firms. An underlying assumption in the analysis is that the extent to which the timing of taxation payments affects small firms depends on their business context, internal processes, nature and volume of the flow of funds through the business and financial performance. This allows a focus on the factors which help explain businesses responses to the timing of taxation payments in the context of managing their cash flow. The results found in this study demonstrated the validity of this approach.

By timing of taxation payments we are referring to the specific mechanisms for payments and the frequency of payments rather than the rates of taxation. This is an important study not only because it provides original empirical evidence on the effects of the timing of the payment of taxation but it because it can also contribute to the current policy debates surrounding the effects of the taxation system on small firms (HMRC, 2005) as well as the broader relationships between government and small firms (Hampton Review, 2005). Small firms' perceptions of the regulatory burden are, in part, affected by their experiences of the taxation system.

The conceptual framework used in the study involved a systematic analysis of:

(i) the financing and financial management of small firms;
(ii) the main factors affecting cash flow, including how this is managed and funded;
(iii) the methods of payment of taxation and how the timing of the payment of taxation is integrated into business operations;

(iv) the relative importance of the effects of the timing of tax payments on cash flow in relation to other factors;

(v) how the effects of the timing of taxation payments vary according to business context, processes and performance.

The results of the study found that the timing of taxation and the available methods of payment was not necessarily problematic for small firms. Indeed, it was the how these payments interacted with other structural and processual factors that led to specific outcomes and effects. Data from the focus group, face to face interviews and telephone survey confirmed this in that the timing of payment was shown to be a problem that affects certain businesses under specific conditions. We found that almost a third (31%) of businesses had difficulty in meeting a taxation deadline for payment although the effects differed according to taxation type and business characteristics. These effects also varied considerably in terms of how critical they were for the businesses. This finding leads us to search for the type of conditions under which businesses are most affected and the characteristics of firms that are most likely to be affected. A multivariate analysis sought to develop this point.

This Chapter will provide an overview of the results of the report which form a basis for developing some policy implications and recommendations.

7.2 Financing and Financial Management

One of the underlying propositions in the research was that the impact of taxation on cash flow in small businesses is likely to vary between firms, influenced by the way a business is managed, the type of inflows and outflows of funds as well as by the strength of its performance. The performance of the businesses varied across the sample: this is typical of the small business population which is regarded as

heterogeneous and dynamic. Sales had increased during the previous 12 months in 40% of businesses; in about one third they were about the same whilst in just under a quarter (24%) they had declined. Two-thirds of the sample of firms were reported to be profitable during the previous 12 months, with the rest divided between those reporting losses and breaking even.

'Getting the money in' was one of the main day-to-day tasks of owner-managers: this was mentioned in the focus group but also highlighted by the telephone survey. Financial management varied in the businesses studied although there was little evidence to suggest that their systems were inadequate or not able to cope with the payment methods and timing of taxation. Almost one in 10 businesses had an in-house professionally qualified accountant and a third had an in-house book keeper. In house capacity and expertise was bolstered by the use of external advisers, particularly accountants, across the sample. The majority of the firms (57.6%) made use of external professional accountants to complete their tax returns, rather than by relying solely on an accountant in-house. If this group are combined with those using in-house accountants, and also those firms receiving some external professional help, then only 11% of firms completed all their tax returns without a professionally qualified accountant. Clearly, any messages and implications from this research needs to communicate with these 'key influencers' as they also affect the thinking and strategies of small business owner-managers in relation to payment and payment methods.

7.3 Cash Flow in Small Firms

A focus on cash flow issues in the business provided an important background for the examination of the impact of the timing of tax payments on small firms. Indeed,

the timing of the payment of taxation may be regarded as both a contributor to the cash flow of businesses and the timing is also important because it has to be absorbed into an already existing cash flow situation. The study revealed a number of important observations.

First, the incidence of cash flow problems is uneven across the sample; some businesses appear to suffer more than others. This unevenness is concentrated in businesses with particular characteristics and particular types of performance.

Second, late payment by clients and customers is a major cause of cash flow problems. Obviously, where business owners encounter problems 'getting money in', this reduces the resources available to meet their working capital requirements, including taxation payments. Payments to suppliers, employees and the tax authorities may have to be delayed. Clearly, this can have adverse, not to say disastrous consequences for businesses. Business owners address cash flow difficulties in a variety of ways, but primarily by using a bank overdraft.

7.4 Methods of Payment of Taxes and Effects on Cash Flow

The management of cash for taxation payments did not appear to vary significantly from the management of other cash inflows and outflows. Tax payments were mainly financed from their ordinary business bank accounts and most business owners meet tax payment deadlines without setting up separate bank accounts or making other separate provision. However, 30% (see Appendix 2; Q28a) of business owners reported putting money aside to meet specific taxation payments. Overdraft borrowing to cover payments was also frequently reported.

Almost a quarter of the surveyed businesses (22.8%) had paid a tax demand electronically. PAYE was most commonly paid electronically (17.0%), followed by Personal income tax/NI contributions (13.2%) and VAT (9.1%). Just 7% of firms eligible paid Corporation Tax by electronic means and these tended to be firms with turnovers between £150,000 to £660, 000. The face-to-face interviews suggested that this was partially driven by a lack of awareness as well as low levels of trust of electronic payment systems.

Liability for tax payments is a major cash flow concern for many small businesses, particularly the requirement that taxes be paid in a one-off lump sum rather than in smaller, though more frequent, instalments. Taxation payments were regarded as another 'bill' and owner-managers had to balance these payments with inflows. Where businesses are cash-poor, owners often have to make a choice between making tax payments and paying key suppliers. A financial shock to the business, such as bad debt, late payment or unpredictable sales revenue can affect small firms adversely and thus impinge on their ability to pay. All business were aware of the penalties associated with failure to meet deadlines and several had incurred them.

Business owners' experiences of cash flow problems associated with the payment for the four types of taxation studied were restricted to a significant minority. This was most notable for Corporation Tax where almost a quarter of respondents reported Corporation Tax payments caused, or contributed to, cash flow problems.

Few business owners perceive the cash available between the accrual of various tax liabilities and the payment dates as providing a cash flow benefit for businesses. For most taxes, either the amounts were too small, or the period for which it was held was too short for such cash assets to be considered substantial enough to offer any great benefit. For some, any cash benefit was outweighed by the costs associated

with acting as what they perceived to be an unpaid tax calculator and tax collector for Government.

7.5 Identifying Those Firms at Risk to Adverse Effects of Taxation on Cash Flow: A Multivariate Approach

The multivariate analysis found that identifying those firms that are affected more by the timing of the payment of taxation is complex and there are few hard and fast precise rules. The results are summarised in Table 6.11. The importance of controlling responses to questions on the various aspects of the tax payment by size, sector, age and legal status is clearly illustrated.

Overall, it is possible to draw the following conclusions:

- It is not the *very* smallest firms who are experiencing taxation payment problems;
- There are *sectoral effects* independent of size and age of business. This depended on the type of taxation payments;
- Sole proprietorships and Partnerships are more likely to report that tax payments create cash flow problems than limited liability companies;

Having controlled for a set of business characteristics (size, sector, age and legal status) the following factors emerge as independent influences on the likelihood of a business to report cash flow problems associated with tax payments:

- How sales are generated is an important indicator of potential cash flow problems – especially with respect to VAT and Corporation Tax
- As expected, variability and unpredictability of sales are important factors affecting the propensity of small firms to experience cash flow problems
- Late payment is a crucial factor in determining the probability of a business to report cash flow problems, with respect to each of the four types of taxation generated.
- Growing businesses do not experience problems with tax payments on their cash flow;
- Paying VAT by electronic means is positively associated with a business reporting a negative impact of taxation payments on cash flow.

7.6 Implications for Policy in the Longer Term

The preceding analysis has shown that the timing of taxation is, in general, not a problem for small firms. Yet, although most business owner managers were relatively satisfied with the timing of taxation payments, only 15% of the telephone respondents said that there should be no changes to the system. The timing of taxation payments often becomes a problem in the context of businesses poor financial, or liquidity, conditions and it is this aspect that needs some consideration. Poor financial conditions can be a function of a number of factors, including poor financial management; unequal relationships with customers and suppliers; and characteristics of the economic environment in which the business operates. The study has shown that late payment and bad debt are two symptoms of these financial conditions. Neither of these is under the direct influence of tax administrators but these factors appear to be influencing the perception of the burden of the timing of taxation. The timing of taxation payments is seen as a problem when it is superimposed on an already existing weak financial environment rather than the taxation system having inherent flaws.

Where late payment causes problems businesses can make use of a statutory right to interest charges. Although this survey showed that a high percentage of businesses were aware of this, only 20% of those reporting late payment as an issue were prepared to use this right. The reasons given for this are that the interest rate that can be charged is low and also using this procedure risks damaging the customer/supplier relationship. The issues of late payment and bad debt are purely commercial ones and ones in which the scope for Government intervention is limited. However it is important that tax administrators remain aware of the effect these have on the perceived and actual burden of the timing of taxation payments, when developing taxation policy and procedures.

Suggestions for improving the taxation system by small business owners and managers emphasised a need to increase the flexibility of payment arrangements and probably the need to pay more frequently to avoid the build-up of accrued funds for large payments. It is quite clear that owner-managers were keen on the ability to make tax payments in several instalments rather than in one lump sum: two-thirds (66.5%) agreed with this suggestion. This was also the main change preferred by business owners (50.2%). Businesses can gain a cash-flow benefit through tax being collected before it is due to be paid to the tax authority. The survey showed that few businesses (only around 14%) perceived this as a benefit; either the amounts are too small or the period too short to be considered substantial enough to offer any great benefit. The findings also show that over 70% of businesses merely deposit accrued tax in their ordinary business bank account; about 16% put it into a separate account. Although we cannot assume that not 'putting money aside' for tax payments necessarily indicates bad tax planning (businesses may be able to meet tax payments without separating funds), failure to do so may increase the risk of 'tax' being used for other business purposes and indeed overdraft borrowing to cover tax payments was frequently reported. Given the significant percentages of businesses that would like a more flexible tax system that offers the opportunity to make tax payments more frequently than at present, this could be a fruitful area for policy development that could provide real cash-flow benefits for small businesses.

Finally, the research suggests a need to raise the depth and scope of communication between small firms and HMRC, to increase awareness of how any negative impacts of taxation payments on cash flow may be minimised within existing tax rules. This is illustrated by the fact that some of the suggestions made by owner-managers on how the taxation system could be improved are already in place but are not used (such as the cash accounting scheme). It is also important that the key advisers to small businesses, mainly accountants, are fully aware of currently alternative

methods of payments if the underlying inertia amongst business owners in relation to methods and timing of taxation payments is to be tackled. Related to this is the need to raise awareness and use of online payments for taxation. In order to improve the use of online payments, business owners not only need continued financial incentives but also require to have their confidence built up to trust electronic means of payment. Further work by HMRC to increase awareness of the procedures currently available for taxation payments and also further promotion of the on-line systems available would be likely to address some of the issues raised in the survey.

REFERENCES

Hampton, P. (2005) *Reducing Administrative Burdens: Effective Inspection and Enforcement*, HM Treasury, HMSO, London.

HMRC (2005) *Working towards a new relationship: A consultation on priorities for reducing the administrative burden of the tax system on small businesses*, HMSO, London.

APPENDICES

APPENDIX ONE

Focus Group Topic Agenda
HMRC 4 May 2005
ACCA Lincolns Inn Fields, London

1. Introduction (5 mins)

1.1 Moderator: Thank for attending.

1.2 Introductions: round table introductions.

1.3 Moderator: Aims of the meeting

- Role of FG in the research project: influence telephone survey; collect experiences and views in their own right.
- Brief participants
- Make clear we are talking about the methods & timing of payments NOT the financial cost or rates of tax. Need to steer them away from simply talking about whether the level of different forms of tax is too high.
- Make it clear that we are talking about small firms, ie under 50 employees and £1.5m.

1.4 Format of the meeting and conventions: rules of engagement and confidentiality agreement

- Make it clear that we are interested in their experiences combined with examples rather than un corroborated views.

Moderator: *any questions at this stage?*

2. Discussion Topics (75 mins)

2.1 Could we begin by looking at what you consider to be the main cash flow issues faced by small firms?

- i.e. What are the pressures on cash-flow on a day-to-day basis?
- Relations with creditors
- Relations with debtors
- Causes of any problems
- Variations by type of small firm: eg fast growth, young, big projects with long lead-time; lumpy payment periods

2.2 General impacts of timing of tax payments on cash flow

- How does this fit within above? Relative weight of tax payment timings?
- Does the tax system create/permit any benefits
- Does the tax system create problems for small business owners - if so, what?

2.3 Effects of different forms of taxation on cash flow

- VAT
- Corporation
- Income Tax, PAYE,
- Employers NICs etc
- Collection of payment for SSP, SMP, student loan payments

2.4 Effects of timing of taxation payments by type of small firm

- Is this an across the board issue or for particular types of firm?

- e.g. size, sector, nature of product or service, age of business, growth rate of business, management composition

Break (5 mins) *(around 1.15)*

2.5 Coping strategies for managing cash-flow

- Managing debtors
- Managing creditors
- Forms of payment and income preferences

2.6 Role of advisers in managing cash-flow

- In their coping strategies, who do owner-managers use?
- Why are these used?
- Who do they use specifically in relation to taxation issues?

2.7 Awareness of government schemes to help with tax payments

- Why do small firm owners not make more use of the various government initiatives to improve the management of cashflow?
- Use of e payments?

3. Moderator: Any other issues we have not covered?

Conclusions / Summary **(5 mins)**

Explain next phase of research.

Thank you statement

Close (90-120 minutes)

APPENDIX TWO

HMRC Project Telephone Questionnaire: Weighted Frequency Tables

QB We are only interviewing the self-employed and small businesses that have fewer than 50 employees. Can I check, in total, including yourself and any other partners or directors, how many people currently work for your business?

1-4 employees	92.3
5-9	4.7
10-19	2.3
20-49	0.7
Weighted N	875
Unweighted N	875

Qb1 How many owners/proprietors are there?

1	57.4
2	34.0
3	3.4
4	0.7
5	0.1
Don't Know	4.5
Weighted N	875
Unweighted N	875

QC And how many people, in total, worked for your business 12 months ago?

0 (Business not started then)	5.6
1-4	81.4
5-9	9.9
10-19	2.2
20-49	0.8
50 or more	0
Don't know	0.1
Weighted N	875
Unweighted N	875

QD Can I check, in which year did your business start trading?

Pre-1980	15.2
1980-9	16.7
1990-9	27.6
2000-	39.7
Don't know	0.9
Weighted N	875
Unweighted N	875

QE We also need all the businesses we interview to have a sales turnover of *less than* £1.5 million. Can I check…

Under £58,000	35.0
£58,000 - £149,999	31.3
£150,000 - £249,999	15.9
£250,000 - £659,999	11.4
£660,000 - £999,999	2.9
£1 million to £1.49 million	1.7
Don't know	1.5
Refused	0.3
Weighted N	875
Unweighted N	875

QH What is the legal status of your business? Read out; code ONE.

Self-employed sole trader	48.6
Partnership	16.2
Limited liability partnership	0.4
Limited company	34.7
Charity	0.1
Don't know	0
Weighted N	875
Unweighted N	875

Q1 Approximately what proportion of your purchases, by value, are:

(a) Cash purchases or cash payment on delivery (includes cheque books and credit cards)

No cash purchases	21.5
Some cash purchases	60.4
All cash purchases	15.2
No data	3.0
ALL RESPONSES	100.0
Weighted N	875
Unweighted N	875
Median	15.0
Mean	34.8
Notes: mean and median calculated after excluding cases with missing data (weighted N=849; unweighted N=855).	

(b) credit or invoice purchases

No credit or invoice purchases	15.2
Some credit or invoice purchases	60.4
All credit or invoice purchases	21.5
No data	3.0
ALL RESPONSES	100.0
Weighted N	875
Unweighted N	875
Median	85.0
Mean	65.2
Notes: mean and median calculated after excluding cases with missing data (weighted N=849; unweighted N=855).	

Q2 Approximately what proportion of your credit or invoice purchases do you usually pay within the agreed credit period (by value)? ESTIMATES WILL SUFFICE IF PRECISE FIGURES ARE NOT AVAILABLE.

None	0.5
Some	38.9
All	57.4
No data	3.1
ALL RESPONSES	100.0
Weighted N	742
Unweighted N	795
Median	100.0
Mean	89.2
Notes: mean and median calculated after excluding cases with missing data (weighted N=719; unweighted N=774).	

Q3 If you need to extend the credit period with your suppliers, do you usually find them…? READ OUT. SINGLE CODE

willing to renegotiate an extended credit period	37.0
unwilling to renegotiate an extended credit period	6.8
about half and half	13.0
*No need / Do not ask	12.7
Other	0.5
Don't know	30.0
Weighted N	742
Unweighted N	795
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.	

Q4 Approximately what proportion of your sales income is:

(a) cash sales or cash payment on delivery (includes cheque books and credit cards)

No cash sales	34.7
Some cash sales	38.2
All cash sales	24.4
No data	2.7
ALL RESPONSES	100.0
Weighted N	875
Unweighted N	875
Median	30.0
Mean	45.3
Notes: mean and median calculated after excluding cases with missing data (weighted N=851; unweighted N=855).	

(b) credit or invoice sales

No credit or invoice sales	24.4
Some credit or invoice sales	38.2
All credit or invoice sales	34.7
No data	2.7
ALL RESPONSES	100.0
Weighted N	875
Unweighted N	875
Median	70.0
Mean	54.7
Notes: mean and median calculated after excluding cases with missing data (weighted N=851; unweighted N=855).	

Q5 **Approximately what proportion of your credit or invoice sales do you usually receive payment for within the agreed credit period (by value)?** ESTIMATES WILL SUFFICE IF PRECISE FIGURES ARE NOT AVAILABLE.

None	2.1
Some	69.7
All	24.6
No data	3.6
ALL RESPONSES	100.0
Weighted N	662
Unweighted N	736
Median	90.0
Mean	72.3
Notes: mean and median calculated after excluding cases with missing data (weighted N=638; unweighted N=716).	

Q6 **Would you describe late payment by customers as...** READ OUT

A critical problem for your business?	13.1
A major problem?	19.5
A minor problem?	32.3
Or not a problem at all for your business?	33.5
Don't Know	1.6
Weighted N	664
Unweighted N	737

Q7 **During your last financial year, approximately what proportion of sales turnover have you written off as bad debt (i.e. that you expect to remain unpaid)?** ESTIMATES WILL SUFFICE IF PRECISE FIGURES ARE NOT AVAILABLE.

None	55.8
Some	41.6
All	0
No data	2.6
ALL RESPONSES	100.0

Median	0
Mean	1.7
Weighted N	664
Unweighted N	737

Q8 **Would you describe bad debt - that is, sales income you have had to write off as:** READ OUT. SINGLE CODE.

A critical problem for your business?	10.8
A major problem?	20.8
A minor problem?	43.6
Or not a problem at all for your business?	23.1
Don't Know	1.8
Weighted N	294
Unweighted N	407

Q9 **Would you say that cash flow problems are …?** READ OUT. SINGLE CODE

A more or less permanent state of affairs for your business	16.7
Fairly frequent, but not permanent	16.9
Occasional	24.1
Quite rare and unusual for your business	41.6
Don't Know	0.6
Weighted N	875
Unweighted N	875

Q10 **(a) Could you please say whether each of the following has caused or contributed to a cash flow difficulty for your business during the past year? Please just answer yes or not for each.** READ OUT. MULTICODE OK

(b) Of those you've mentioned, which was the main cause of cash flow difficulty? READ OUT AGAIN IF NECESSARY. SINGLE CODE ONLY

	ANY (a)	MAIN (b)
Late payment by customers	38.2	31.3
Early payment required by your suppliers	17.6	1.9
Difficult or expensive to get credit from suppliers	9.6	1.7
Either income or outgoings tending to fluctuate	51.1	20.4
High levels of working capital needed	28.8	4.2
Lack of cash flow planning by this business	17.9	2.2
High levels of capital investment in this business	18.1	2.8
Fear of losing customers by chasing debt	16.7	0.1
Having to make tax payments at a specific time	42.9	9.6
Having to pay all of a particular tax in one lump sum	46.3	13.3
Having to make several tax payments at the same time	33.6	4.4
Paying penalties incurred by late payment of tax	19.3	1.2
*Unforeseen circumstances	0.8	0
*VAT too expensive/VAT unspecific	0.6	0
*Other – tax-related reason	-	1.9
other cause of cash flow difficulty	3.7	2.6
Don't know	0	2.4
None of these were causes of cash flow difficulty	22.8	N/A
Weighted N	875	553
Unweighted N	875	621
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.		

Q11 (a) Have your cash flow difficulties led to any of the following in the past year:? READ OUT. MULTICODE OK

ASK IF MORE THAN ONE MENTIONED AT Q11a (CODES 1-11). OTHERS GO TO Q12

(b) **Of those you've mentioned, which was the main consequence of cash flow difficulty?** READ OUT AGAIN IF NECESSARY. SINGLE CODE ONLY

	Effect (a)	MAIN (b)
Lower profit margin / higher costs	2.5	1.1
Use of business savings to cover cash flow needs	1.4	0
Use of bank overdraft to cover cash flow need	59.1	38.4
Took on a loan	21.9	6.4
Use of personal savings to cover cash flow needs	52.0	18.9
*Turning down business as it is likely to entail cash flow problems	0.4	0
*Limiting Business Growth	1.8	-
*Inadequate funds for working capital	1.1	-
*Delayed payment to suppliers	39.2	16.0
*Inadequate funds for investment	1.1	-
*Tax payments not made on time	24.0	5.8
*Staff Redundancies	1.2	-
*Personal Distress	2.1	-
*Bad relations with suppliers	1.2	-
*Can't pay him/herself	0	
Other	2..2	8.0
Don't Know	0	5.4
None of these were consequences of cash flow difficulties	13.5	N/A
Weighted N	675	422
Unweighted N	719	451
Notes: (1) new categories added (*) following post-coding of initial 'other'		

Notes: (1) new categories added (*) following post-coding of initial 'other' responses.

Q12 (a) Are you aware that businesses can charge interest on late payment by customers?

(b) Have you ever used this right?

	Aware (a)	Use (b)
Yes	80.5	9.5
No	19.2	90.5
Don't know	0.3	N/A
Weighted N	875	705
Unweighted N	875	754
Note: (b) only asked of those reporting awareness of the right reported under (a).		

Q13 Is your business registered for VAT?

Yes	72.5
No	27.1
Don't Know	0.5
Refused	0
Weighted N	875
Unweighted N	875

Q14 (a) Which of the following VAT payment methods do you use? READ OUT. MULTICODE OK

(b) Which other VAT payment methods have you heard of? READ OUT THOSE NOT MENTIONED AT Q14a (CODES 1-7). MULTICODE OK.

	Used (a)	Heard of (b)
VAT paid quarterly on invoices issued	82.9	65.5 (n=111)
Annual Accounting Scheme	4.7	43.9

		(n=604)
Cash Accounting Scheme	15.0	36.3 (n=542)
Flat Rate Scheme	3.1	35.3 (n=617)
Retail Point of Sale Scheme	2.4	18.1 (n=619)
Retail Apportionment Scheme	0.4	11.9 (n=632)
Retail Direct Calculation Scheme	0	9.2 (n=634)
*VAT paid monthly	1.7	
*Another method of payment	1.0	N/A
Other reason	1.2	
Don't know	3.4	38.8 (n=634)
Weighted N	634	n/a
Unweighted N	750	n/a
Notes: (1) new categories added (*) following post-coding of initial 'other' responses. (2) for Q14b, the question was asked only of those responding they had not used the specific payment method. Different weighted Ns apply to each payment method.		

Q15a What is the main reason for using the VAT payment methods that you do?
DO NOT PROMPT.

Q15b Are there any other reasons for using these VAT payment methods? PROBE IN FULL: What other reasons? WRITE IN

	MAIN (a)	Other Method (b)
Allows VAT to be collected before payments need to be made	0	0.4
Allows a longer delay between collection of VAT and payment of VAT	0.4	0.4
Easier to calculate VAT payments	1.3	0.8
Ensures predictability of VAT payments	0	0.8
Easier to make payments in smaller instalments than in larger amounts	3.6	2.2
Saves time	0.4	0.4
Your accountant recommend this	10.2	2.1
Not aware of any other method	7.8	2.3
*Usual method	31.7	1.0
*Convenience/ease/simplicity	18.8	5.8
*Suits business needs	7.6	4.1
*Improves cash flow	1.9	3.3
*Default method offered to respondent	4.8	1.1
*To use cash accounting method ie pay VAT only on cash received	2.8	1.5
*Makes managing finances easier	1.2	0.4
*VAT office recommendation	0.9	0.7
Any other reason for using the method you do	0.1	1.4
Don't Know	0.1	0
No particular reason	6.1	76.5
Weighted N	634	634
Unweighted N	750	750
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.		

Q16 When the time comes to pay VAT, does this cause, or contribute to..... READ OUT

A critical cash flow problem?	5.9
A major cash flow problem?	11.8
A minor cash flow problem?	38.0
Or is it no problem at all?	42.7
Don't Know	1.7
Weighted N	634
Unweighted N	750

Q17 Is your business eligible to pay Corporation Tax? IF NO: **Is that because you are not a registered company, or because profits are too low?** SINGLE CODE ONLY

Yes	23.5
No, because not a registered company	65.3
No, because current profits are too low	8.4
No – other reason (SPECIFY)	0.4
Don't Know	2.4
Refused	0
Weighted N	875
Unweighted N	875

Q18 When do you usually pay Corporation Tax? READ OUT. SINGLE CODE ONLY

At the due date	62.6
Earlier than the due date	14.5
Later than the due date	14.3
Don't Know	8.7
Weighted N	219
Unweighted N	362

Q19 When the time comes to pay Corporation Tax, does this cause, or contribute to ... READ OUT. SINGLE CODE ONLY

A critical cash flow problem for your business	8.3
A major cash flow problem	14.9
A minor cash flow problem	31.7
Or no problem at all	39.5
Don't Know	5.5
Weighted N	219
Unweighted N	362

Q20 (a) For your main income from this business do you pay your own personal Income Tax by PAYE or by self-assessment? SINGLE CODE ONLY.

(b) And do you pay your own personal National Insurance Contributions by PAYE or by self-assessment? SINGLE CODE ONLY.

	Q20a Income Tax	Q20b NICs
PAYE	20.0	34.9
Self-assessment	51.2	36.9
Both PAYE and Self-assessment	18.1	11.6
Do not pay (income tax/National Insurance Contributions)	4.4	5.9
*dealt with by accountant	0.8	0
*Direct debit	n/a	1.7
Other	0	0.6
Don't Know	5.5	8.5
Refused	0	0
Weighted N	875	875
Unweighted N	875	875
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.		

Q20c How often do you pay your own personal Income Tax? SINGLE CODE ONLY. READ OUT IF NECESSARY (IF both PAYE and Self-assessment paid then ask for main tax payments)

Q20d How often do you pay your own personal National Insurance Contributions? SINGLE CODE ONLY. READ OUT IF NECESSARY

	Q20c Income Tax	Q20d NICs
Monthly	18.5	56.7
Quarterly	8.5	19.6
Twice a year	42.3	7.4
Once a year	24.3	9.2
Other	1.0	0.8
*weekly	0.9	0.9
*Exempt/do not pay	0.8	0.3
*it varies	0	0.6
Don't Know	2.3	4.2
Refused	0.2	0.2
Weighted N	837	824
Unweighted N	849	828
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.		

Q21 When the time comes to pay your own personal income tax and National Insurance Contributions, does this cause, or contribute to.... READ OUT. SINGLE CODE ONLY

A critical cash flow problem for your business	3.0
A major cash flow problem	11.7
A minor cash flow problem	32.4
Or is it no problem at all	50.0
Don't Know	2.9
Weighted N	850
Unweighted N	857

Q22 Does your business make either of the following payments? READ OUT. CODES 1-2 MAY BE MULTI-CODED

PAYE	44.1
Employers' National Insurance Contributions	39.9
No – neither	50.1
Don't Know	3.9
Refused	0.3
Weighted N	875
Unweighted N	875

Q23a How often do you make PAYE payments? PROMPT IF NECESSARY

Q23b How often do you make Employers' National Insurance Contribution payments? PROMPT IF NECESSARY

	Q23a PAYE	Q23b Employers NICs
Monthly	69.3	69.7
Quarterly	21.1	22.9
Annually	5.6	2.8
*weekly	1.1	0.4
Other	0.7	0.8
Don't Know	2.3	3.4
Weighted N	386	349
Unweighted N	634	600
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.		

Q24 When the time comes to pay PAYE and Employers' National Insurance Contributions, in terms of cash flow does this cause or contribute to... READ OUT. SINGLE CODE ONLY

A critical cash flow problem for your business?	2.5
A major cash flow problem?	10.6
A minor cash flow problem?	32.7
Or is it no problem at all?	54.0
Don't Know	0.1
Weighted N	401
Unweighted N	648

Q25 Variables deleted from dataset.

Q26a Many taxes do not need to be paid until some time after liability for them has accrued. What do you do with this money before making tax payments. Do you…(a) MULTIPLE CODE

Q26b What would you describe as the MAIN use of this cash? READ OUT THOSE MENTIONED AT Q26a. SINGLE CODE ONLY

	Use (a)	MAIN (b)
Add it to your ordinary business bank account?	72.1	71.4
Put it into a separate account ?	18.9	16.3
Reduce interest payments on overdraft borrowing	8.4	5.3
Pay off Bank Loan	3.0	1.7
*pay suppliers earlier	0.7	0.3
*buy more raw materials or stock	0.9	0.3
*add to bank savings	1.9	0
*pay wages & salaries	0.6	0
Other use	2.0	2.1
Don't Know	1.5	2.6
None of these ways	3.1	NA
Weighted N	859	826
Unweighted N	868	839

Q27 Would you describe having cash available because tax payments are made some time after accrual of liability …? READ OUT. SINGLE CODE ONLY

A major benefit for cash flow?	12.8
A minor benefit for cash flow?	18.2
Or does it make no real difference?	63.2
Don't Know	5.8
Weighted N	859
Unweighted N	868

Q28a How do you usually fund your tax and national insurance bills? Do you use any of the following funding sources.... READ OUT

Money especially put aside for payment	29.6
General business bank account savings	68.5
Overdraft borrowing	21.0
Bank Loan	4.9
Personal savings	11.7
Other	1.0
Don't Know	0.7
Refused	0
Weighted N	859
Unweighted N	868

Q28b Do you use all of these funding sources for each type of tax or national insurance bill you have, or do you use particular funding sources for particular bills? PROMPT IF NECESSARY

Yes – use the same funding for all bills	84.7
No – particular funding for particular bills	11.3
Don't know	4.0
Weighted N	213
Unweighted N	214

Q28c Where do you usually get the funds from to pay your……

(a) (ASK IF Q17 "1") **Corporation Tax bill? DO NOT PROMPT**. MULTICODE OK

(b) (ASK IF Q13 "1") **VAT bill? DO NOT PROMPT**. MULTICODE OK

(c) (ASK IF Q22 "1-2") **PAYE and Employers' National Insurance Contributions?** DO NOT PROMPT. MULTICODE OK

(d) (ASK IF Q20a "1-3, 5" OR Q20b "1-3, 5") **Your own personal income tax & National Insurance bill? DO NOT PROMPT**. MULTICODE OK

	CT bill (a)	VAT bill (b)	PAYE/ Employer NICs (c)	Personal tax/NI bill (d)
Money especially put aside for payment	16.0	38.6	0.8	37.0
General bank account savings	84.0	59.4	96.7	31.1
Overdraft borrowing	5.3	6.6	5.4	21.6
Bank Loan	3.4	1.1	1.4	0.5
Personal savings	4.7	1.1	1.4	52.9
Other	0	0	0.8	0.5
Don't Know	0	0	0	0
Refused	0	0	0	0
Weighted N	4	12	9	24
Unweighted N	10	26	23	30

Q29 **In your business, have you made payments electronically (such as BACS, direct debit, internet banking etc) for any of the following during the past year?** READ OUT

	%	Weighted N	Unweighted N
VAT?	9.1	634	750
Corporation Tax?	7.0	206	347
PAYE?	17.0	401	648
Personal Income Tax & National Insurance Contributions?	13.2	846	855
No – none of the above	77.2	859	868
Don't know	1.3	859	868

Q30 **(a) What is your MAIN reason for making payments online?** DO NOT PROMPT. SINGLE CODE ONLY

(b) Are there any other reasons for making payments online? DO NOT PROMPT. MULTICODE OK

	MAIN (a)	Other (b)
Allows a longer delay between collection and payment	3.1	1.8
Saves time in making payments	4.4	12.0
More convenient to make payments	63.1	11.8
Your accountant told you to	3.6	0.1
*offered financial incentives	4.0	2.2
*cost effective/cheaper	3.8	4.3
*can be sure payment can be made on time	1.0	1.2
*safer/more secure	0.1	0.1
Any other reason	4.9	2.2
None of the above	2.4	48.3
No data	9.7	8.2
Weighted N	196	196
Unweighted N	247	247
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.		

Q31 In the last two years, has there been an occasion when you have had difficulty in meeting a deadline for a payment to Inland Revenue or Customs & Excise?

Yes	31.0
No	68.7
Don't Know	0.4
Refused	0
Weighted N	875
Unweighted N	875

Q32 For which of the following? READ OUT. MULTICODE OK.

VAT	49.9
Corporation Tax	13.1
PAYE and Employers' National Insurance Contributions	30.8
Personal Income Tax & National Insurance Contributions	45.6
Other (SPECIFY)	0
Don't know	0.1
Weighted N	271
Unweighted N	318

Q33 Was the issue resolved in any of these ways? READ OUT. MULTICODE OK

Renegotiated payment terms with tax authorities	27.3
Used business savings to cover cash flow needs	22.3
Used bank overdraft to cover cash flow needs	37.6
Used bank loan to cover cash flow needs	11.5
Delayed payment to suppliers	23.3
The payment was submitted late	39.5
It was resolved in some other way	4.1
*Personal savings	6.7
*Paid – but with difficulty	2.5
*Issue was not resolved/still ongoing	1.8

Don't Know	1.8
Weighted N	271
Unweighted N	318
Notes: (1) new categories added (*) following post-coding of initial 'other' responses.	

Q34 Have you ever received a penalty or a fine for NOT meeting a payment deadline to Inland Revenue or Customs & Excise?

Yes	26.6
No	73.0
Don't Know	0.4
Refused	0
Weighted N	875
Unweighted N	875

Q35 For which of the following did you receive a penalty or fine? READ OUT. MULTICODE OK.

VAT	32.7
Corporation Tax	7.7
PAYE and Employers' National Insurance Contributions	21.1
Personal Income Tax & National Insurance Contributions	41.4
Other (SPECIFY)	3.3
Don't know	4.0
Weighted N	233
Unweighted N	260

Q36 (a) Which, if any, of the following changes to the timing and method of payment of tax would benefit your business? Please mention all that apply. READ OUT. MULTICODE OK

(b) Which of these is the MAIN change that would benefit your business? READ OUT ANSWERS AT Q35a. SINGLE CODE ONLY

	Change (a)	MAIN (b)
A longer period between accrual of tax liability and date of payment	38.6	13.2
Being able to make tax payments in several instalments rather than a lump sum	66.5	50.2
Being able to avoid making several payments for different taxes at the same time	47.4	6.0
A greater variety of payment methods available	40.4	7.1
To be able to earn interest on tax payments made ahead of the due date	54.1	13.5
Any other change	10.7	10.0
None – no changes would benefit your business	14.9	N/A
Don't know	1.2	N/A
Weighted N	875	615
Unweighted N	875	627

Q37 Does your business employ a …? READ OUT

	Yes	No	No data	Weighted N	Unweighted N
An in-house professionally qualified accountant	9.1	90.9	0	875	875
An in-house dedicated book-keeper or someone other than a professionally qualified accountant	33.4	66.5	0.1	875	875

Q38 Which of the following best describes the accounting activities of your business? READ OUT. SINGLE CODE ONLY

We do all our own tax returns in-house	14.5
We prepare our tax returns with some help from an external professionally qualified accountant	27.0
Our tax returns are prepared by an external professionally qualified accountant	57.6
Other (SPECIFY)	0
Don't know	0.9
Weighted N	875
Unweighted N	875

Q39 Would you describe the product or service markets in which your business operates as …?

Extremely competitive	30.4
Very competitive	31.0
Fairly competitive	33.7
Not at all competitive	4.2
Don't know	0.8
Weighted N	875
Unweighted N	875

Q40 Is it customary for your business to receive staged payments for goods and services provided?

Yes	24.3
No	75.0
Don't know	0.7
Weighted N	875
Unweighted N	875

Q41 Does the sales turnover of your business vary significantly from one month to the next?

Yes	70.4
No	29.2
Don't know	0.4
Weighted N	875
Unweighted N	875

Q42 Is this variation predictable?

Yes	33.2
No	66.4
Don't know	0.4
Weighted N	616
Unweighted N	611

Q43 Allowing for inflation, did your sales turnover increase, decrease or stay the same during your last financial year?

Increase	37.8
Decrease	24.0
Stay the same	29.8
Don't know	8.1
Refused	0.3
Weighted N	875
Unweighted N	875

Q44 Allowing for inflation, during the next financial year, do you expect to …? READ OUT. SINGLE CODE ONLY.

Grow turnover substantially (by 50or more)	5.3
Grow turnover moderately (up to 50)	36.0
Keep the same turnover	37.6
Reduce turnover	15.4
Close the business/retire	2.5
Don't know	3.2
Weighted N	875
Unweighted N	875

Q45 Did your business make a profit, make a loss or break even in the last 12 months?

Make a profit	66.0
Make a loss	12.8
Break even	14.9
Don't know	6.1
Refused	0.3
Weighted N	875
Unweighted N	875

Q46 Allowing for inflation, was this profit performance better, worse or the same as the previous year?

Better	36.9
Worse	23.5
The same	27.6
Don't know	11.8
Refused	0.3
Weighted N	875
Unweighted N	875

Q47a During the next financial year, do you expect to …? Read out; code ONE.

Make a higher profit than the last financial year	37.7
Make a lower profit	15.3
Make the same level of profit	34.9
Make a loss	6.1
Close the business/retire	2.1
Don't know	3.9
Refused	0
Weighted N	875
Unweighted N	875

Q48 **(a) Has your business used any of the following forms of finance in the past two years?** READ OUT. MULTICODE OK

(b) Which of these is the MAIN source of finance? ? READ OUT CODES AT Q48a.

	Used (a)	MAIN (b)
Personal savings	44.9	20.5
Reinvested profits	36.9	21.2
Equity from family and/or friends	11.2	0.7
Venture capital/business angels	0.9	0.6
Loan from family/friends	12.2	5.3
Bank overdraft	47.4	32.8
Bank loan	24.0	9.0
Leasing or hire purchase	22.6	6.5
Factoring	1.7	0.4
Grant (central or local government)	3.3	1.2
None of these	18.6	n/a
Don't know	0.1	2.0
Weighted N	875	711
Unweighted N	875	742

Q49 **What is your highest educational qualification?** Read out; code ONE.

O levels/GCSE/NVQ2	22.9
A levels/BTEC/NVQ3	20.2
Degree/ Higher BTEC/HND/NVQ4	22.4
Higher Degree/NVQ5	5.4
Other qualifications	7.3
No formal qualifications	18.5
Don't know	3.1
Refused	0.1
Weighted N	875
Unweighted N	875

Q50 Do you hold any formal qualifications in finance, accounts or book-keeping?

Yes	10.0
No	90.0
Weighted N	875
Unweighted N	875

Q51 How would you best describe the ethnic group to which you belong?
PROMPT AS NECESSARY

White British	92.3
White other	2.3
Black – British	0.6
Black – African	1.0
Asian – British	0.3
Asian – Indian	1.2
Asian – Pakistani	0.6
Asian – Other	0.6
Chinese	0.3
Mixed – White and Black Caribbean	0
Mixed – Other	0
Refused	0.9
Weighted N	875
Unweighted N	875
Note: some categories with '0' reported because cases exist; only when weighted do they round to zero.	

APPENDIX THREE

Topic Guide For HMRC Survey:
Effects of the Timing and Methods of Tax Payments in Small Businesses

Date:
Name of Respondent:
Name of Business:
Address:
Telephone Number:
Gender:

1. Introduction

Thank you for allowing me to come and visit your business. The purpose of this interview is to understand more about businesses like yours and appreciate the challenges of managing cash flow in small firms. We are particularly interested in how you manage the *timing and methods* of tax payments and how this affects your cash flow.

Everything we discuss is confidential and no individuals or businesses will be named in our report. In order to help save time and ensure that I get an accurate record of what is said is it ok if I record our meeting?

2. Profile of the Business

Could I start by asking you a few questions about the background of the business.

- Date when trading commenced
- Legal status of business – recent changes in legal status?
- Main activity of business
- Employment – current position, types of jobs, change over time
- Business objectives – stability, growth (moderate, fast)
- Recent performance - sales, profit
- Influences on business performance:
    - product market competition
    - Seasonality / cyclical nature of sales

3. Finances in the Business

Let me now turn to asking about the financing and financial structure of the business.

- Responsibilities for finance
- Financial structure of the business: establish debt (bank loan etc) and equity structure (Show a card if necessary).
- Use of external finance – debt, equity?;
- Importance of external finance to the business
- Ease of obtaining external finance

4. Cashflow practices

We are particularly interested in your inflows and outflows of cash

- Who has responsibilities for handling cashflow matters in relation to:
  - paying suppliers
  - agreeing credit terms with customers & suppliers
  - chasing debtors – how is this done?

- do you use any software for organising your finances?

- Role of accountant in financial matters: balance of activities/ responsibilities

- Income & outgoings – variability, predictability, staged payments

- Supplier credit – terms, importance, variation, reasons for variation, ability to meet terms, consequences of failure to meet terms

- Credit to customers – terms, importance, variation, reasons for variation

- Problems of late payment & bad debt:
  - significance to the business
  - what do you do about it?
  - use of late payment rights & reasons for using/not using

- Perception of handling cash flow as a problem:
  - nature & extent of problem
  - causes of cash flow difficulties
  - how are cash flow difficulties handled
  - consequences of cash flow difficulties – ask for examples (circumstances, reasons, outcomes)

5. Impact of taxation on cashflow

This is the central element of the research is the impact of the timing of tax payments on your cashflow

- Check types of tax payment made:
  - VAT
  - Corporation Tax
  - PAYE
  - personal tax/NICs

- Method & timing of payment – need detail on each of the 4 types:
  - reasons for choosing each method
  - whose responsibility deciding when to pay
  - use of electronic payments - which taxes? reasons?

- Perception of method & timing of tax payments as a problem:
  - awareness of due dates for payment of each different tax
  - what sort of planning they do to meet tax payments?
  - what would make planning easier?
  - which tax payments?

  - nature of problem?
  - causes – why is this a problem?
  - consequences - means of addressing the problem, renegotiate payment terms with tax authorities
  - any penalties/fines for late payment of taxes - reasons, circumstances, outcomes

- Perceptions of money due to become tax payments:
  - separate or bundle with all income?
  - explore what they do with the money collected (bank savings, reduce overdrafts/loans, other uses)
  - explore rates of interest
  - treat different tax payments same or differently – why?
  - considered a cash flow benefit or not?

- Any suggestions how the tax system could be improved (emphasise method & timing of payments, rather than tax rates)?

6. Profile of the Owner-manager

Could I conclude with a few questions about you and your business?

- Where do you go for advice? Memberships of external organisations? (eg Chamber of Commerce). Why?
- Education – including management qualifications
- Previous work experience – including self-employment/business ownership
- Age

That ends my questions. Is there anything else that you would like to add?

THANK YOU STATEMENT