

NSBA 2014 SMALL BUSINESS TAXATION SURVEY



FOREWORD

April 15 looms. Instead of celebrating the return of warmth to Washington, D.C., and across the nation following a grueling winter, the month of April is now that dreaded time of year when Americans of all stripes bang their heads against the proverbial tax wall. America's small-business community is uniquely impacted by financial and administrative burdens imposed by the byzantine federal tax code. Regularly ranked among the top issues facing small businesses, federal taxes are an ever-growing frustration with countless sun-setting tax provisions, retroactive extensions and legalese permeating even the simplest of tax rules and proposals. Now in its fourth year, NSBA's annual Small Business Taxation Survey provides small-business opinions on a broad array of federal taxes and tax policies.

Celebrating more than 75 years as the nation's first small-business advocacy organization, NSBA's mission is to address the needs and represent the concerns of the small-business community. A staunchly nonpartisan organization where our members determine our policy priorities, NSBA's surveys aim to provide those members, policymakers, thought leaders and the media with critical data on the small-business community. Alongside our semiannual Economic Reports, this taxation survey and a host of other issue-based surveys are conducted throughout the year.

While the actual tax liability for small firms is a huge issue, the sheer complexity of the tax code—along with the mountains of paperwork it necessitates—is actually a more significant problem for America's small businesses. In 2014, 40 percent of small businesses reported they spend more than 80 hours per year dealing with federal taxes—that's two full work weeks spent just on federal taxes. Nearly 60 percent of small firms spend more than 40 hours per year on federal taxes alone. The time it takes isn't the only administrative burden either, almost half report they spend more than \$5,000 annually on the administration of federal taxes in the form of accountant fees, internal costs, legal fees and so on.

The overwhelming majority of small firms, 86 percent, are forced to pay an external tax practitioner or accountant due to this massive complexity. Just 12 percent report they handle their taxes within their firms, either themselves or a member of their staff. Furthermore, when asked to rate the most significant challenge posed by the federal tax code to their business, the majority, 53 percent, picked administrative burdens while 47 percent said financial burdens.

The majority of small businesses, 59 percent, say that federal taxes and credits or deductions have a significant to moderate impact on their business decisions while 73

percent say federal taxes have a significant to moderate impact on the day-to-day operation of their business.

When it comes to the ongoing debate of sales taxes and how to deal with online transactions, small businesses again expressed the most concern over the complexity of the vast web of rules and requirements among various states, counties, cities and municipalities, as well as the tax liability and threat of audits given sales tax complexity and potential for inadvertent mistakes.

Not surprising, given 83 percent of small businesses are pass-through entities—meaning they pay taxes on business income at the individual owners' income tax level—income taxes were ranked the most burdensome administratively. Payroll taxes were ranked the most burdensome financially, by small firms.

When it comes to public policy, the clear majority of small businesses (67 percent) support broad tax reform that will reduce both corporate and individual tax rates coupled with reduced deductions. Slightly less, 53 percent say they would support replacing the existing code with the Fair Tax which would implement a 23 percent tax on the end point-of-sale for all goods.

Reducing the deficit is another top priority for America's small businesses, inextricable from the tax reform debate. To address the deficit, the two proposals supported by the majority of small businesses are: an across-the-board cut for federal agencies; and eliminating all tax credits and deductions in conjunction with dramatically lower income tax rates.

Unfortunately, the current U.S. Tax Code punishes work, investment, risk-taking and entrepreneurship, and is becoming an insurmountable hurdle for the growth of existing businesses and creation of new firms. As such, NSBA has embraced nine principles that any responsible comprehensive tax reform package ought to incorporate, which are included at the end of this survey packet.

The results of this survey are clear proof that our current system is unsustainable.

Conducted on-line among more than 1,100 small business owners March 18-28, we hope this survey provides timely and useful information on how taxes are impacting America's small-business community.



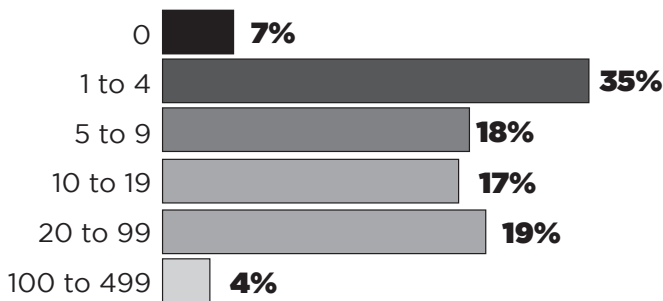
Jeff Van Winkle
NSBA Chair
Clark Hill



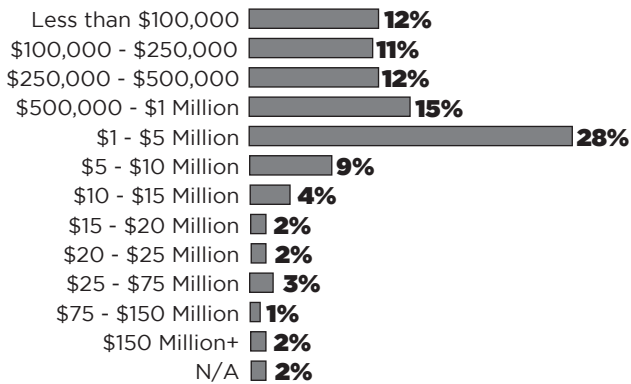
Todd McCracken
NSBA President and CEO

DEMOGRAPHICS

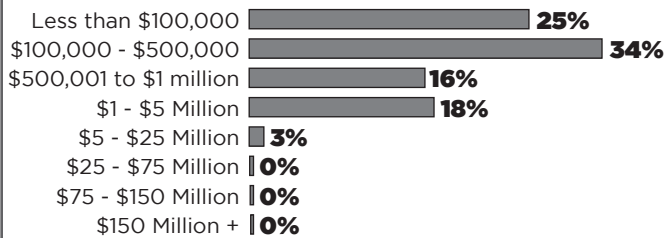
How many total full-time personnel are currently employed by your business?



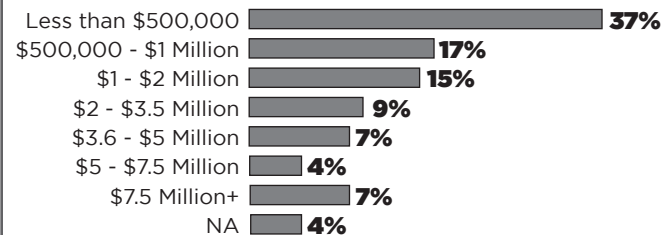
What were your gross sales or revenues for your most recent fiscal year?



What was your total payroll for the most recent fiscal year?



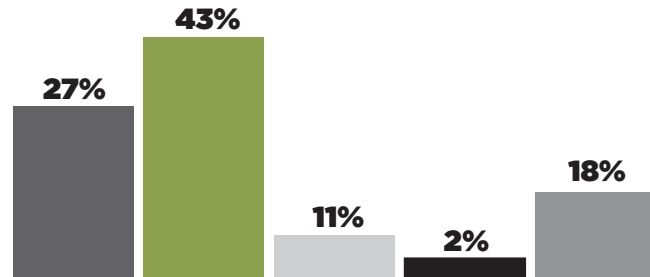
Please estimate the total value, including assets, of your company today?



It is worth noting that the businesses surveyed represent a slightly larger proportion of c-corps than what is found in the at-large small-business community where approximately 17 are c-corps.

Which of the following best describes the structure of your business?

■ CORPORATION ■ PARTNERSHIP ■ S-CORP
■ LLC ■ SOLE PROPRIETORSHIP



Which of the following best describes the industry or sector in which your business operates?

Manufacturing	16%
Professional	12%
Construction	12%
Other Services (except Public Administration)	11%
Scientific and Technical Services	10%
Information (IT)	8%
Retail Trade	6%
Wholesale Trade	6%
Health Care and Social Assistance	3%
Transportation and Warehousing	3%
Real Estate, Rental and Leasing	3%
Agriculture, Forestry, Fishing and Hunting	3%
Administrative and Support	1%
Educational Services	1%
Accommodation and Food Services	1%
Arts, Entertainment, and Recreation	1%
Insurance	1%
Finance	1%
Management of Companies and Enterprises	1%
Waste Management and Remediation Services	1%
Utilities	1%

While the industry groupings are consistent with past surveys, the categories were changed to match up with NAICS codes to provide better uniformity amongst other national surveys.

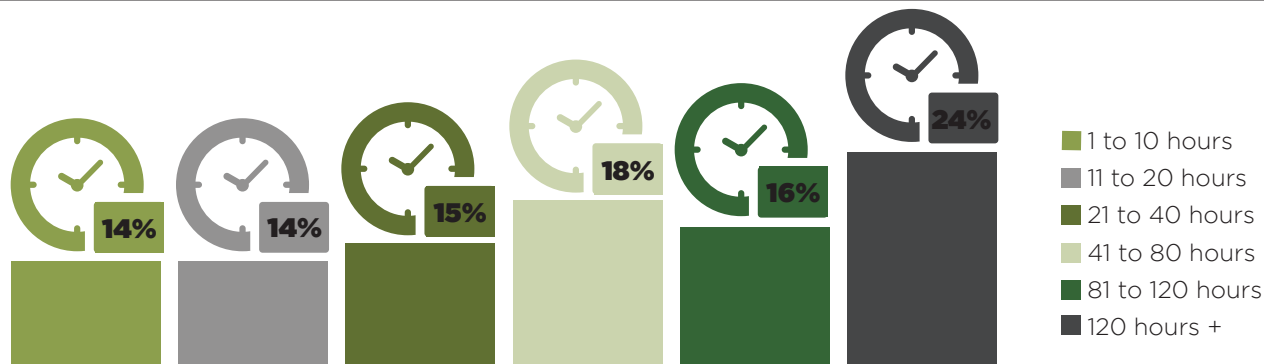
SMALL-BUSINESS TAX BURDEN

Complexity of the tax code remains a significant challenge to small business with the majority saying they spend more than 40 hours per year dealing with federal taxes. Forty percent report spending in excess of 80 hours—two full work weeks—per year on federal taxes. Nearly half of small businesses spend \$5,000 or more annually on the administration (i.e.: accountant fees) of federal taxes alone and 28 percent report spending more than \$10,000. This is before they even pay their actual taxes!

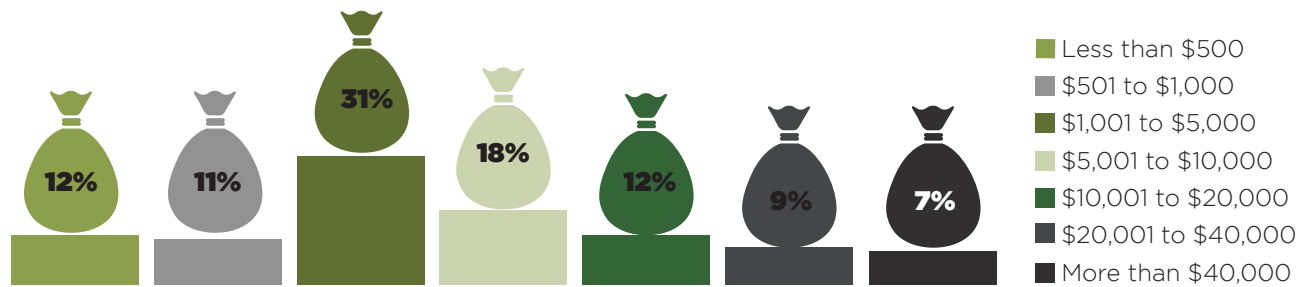
The time and money spent, coupled with the fact 86 percent of small-business owners must pay an external tax practitioner or accountant to handle their taxes ought to be a clear signal that the tax code is far too complex. In ranking the most significant challenge to their business posed by federal taxes, the majority, 53 percent, picked administrative burdens while 47 percent said financial burdens.

When asked to rate a series of 12 common small-business taxes, income taxes (where the majority of small businesses, 83 percent, pay taxes on business income as pass-through entities) and payroll taxes were the top two most burdensome taxes both financially and administratively.

Approximately how much TIME do you spend each year dealing with federal taxes, i.e.: calculating payroll, self-employment or any other business-related tax, filing reports, working with your accountant, estate planning, etc...?



Approximately how much MONEY do you spend each year on the administration of federal taxes NOT including your owed taxes (i.e.: accountant fees, internal costs for administration of taxes, legal fees, etc...)?



How do you prepare your taxes?

	2014	2013
Tax practitioner/accountant	86%	84%
Electronic Filing	29%	3%
Tax Software on Computer	16%	7%
I personally calculate taxes and fill out the paper forms	5%	4%
A member of my staff calculates taxes and fills out the paper forms	8%	2%
Total handling taxes internally	12%	15%

This question was changed slightly from previous years to allow respondents to check any answer that applies. Interestingly, even with this change, there was a drop in small firms who handle their taxes internally versus sending them to an external tax practitioner.

SMALL-BUSINESS TAX BURDEN

Please rank, in order of their ADMINISTRATIVE burden on you and your business, the following taxes.

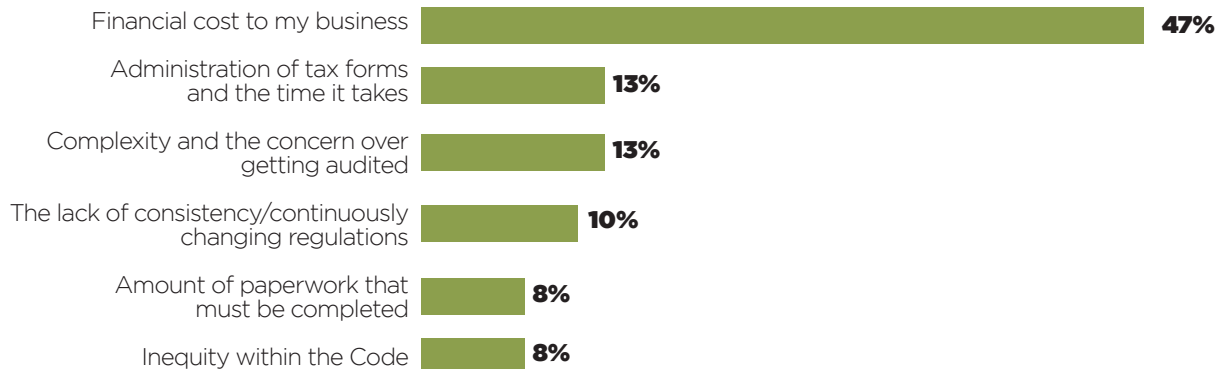
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| 1. Income taxes (I am a pass-through entity) | 7. Capital gains taxes |
| 2. Payroll taxes | 8. Alternative Minimum Tax |
| 3. Corporate taxes (I am a c-corp) | 9. Excise taxes |
| 4. State and local tax compliance | 10. Import taxes (I import) |
| 5. Sales tax | 11. International taxes (I export) |
| 6. Property taxes | 12. Estate tax |

Please rank, in order of their FINANCIAL burden on you and your business, the following taxes.

- | | |
|--|------------------------------------|
| 1. Payroll taxes | 7. Sales tax |
| 2. Income taxes (I am a pass-through entity) | 8. Alternative Minimum Tax |
| 3. State and local tax compliance | 9. Estate tax |
| 4. Property taxes | 10. Excise taxes |
| 5. Corporate taxes (I am a c-corp) | 11. International taxes (I export) |
| 6. Capital gains taxes | 12. Import taxes (I import) |

“ Nearly one-in-three small businesses spend more than \$10,000 per year on just the administration alone of federal taxes. ”

What is the largest burden posed to you by the federal tax code:



Administrative Burdens Outrank Financial Burdens of Federal Taxes

53%

ADMINISTRATIVE
BURDEN



47%

FINANCIAL
BURDEN



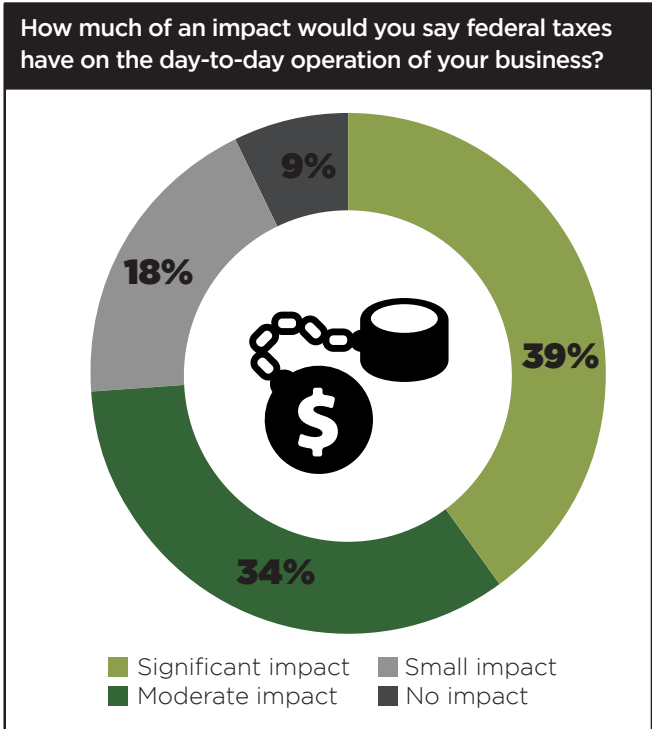
TAX DEDUCTIONS AND CREDITS

The overwhelming majority of small businesses, 73 percent say that federal taxes have a significant to moderate impact on the day-to-day operation of their business and 59 percent say credits and deductions have a significant to moderate influence over their decisions about company and employees. The top four deductions used by small firms are Section 179 expensing, the home mortgage interest deduction, the home office deduction and bonus depreciation.

When asked, generally, what deductions are most important to small-business growth, the majority said allowing the full deduction for health insurance costs—something that self-employed individuals still cannot do. Section 179 expensing, start-up costs deduction and bonus depreciation rounded out the top four.

Which of the following deductions or credits do you take advantage of? (Check all that apply)	
Sec. 179 expensing	34%
Home mortgage interest deduction	31%
Home office deduction	22%
Bonus depreciation	20%
15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and qualified retail improvements	13%
R&E (Also called R&D) credit	8%
Energy efficiency credits	5%
Start-up costs deduction	5%
Work Opportunity Tax Credit	3%
None of the Above*	27%
Other	4%
*The ongoing debate over the so-called "tax extenders" holds significant importance for small businesses as the majority, 73 percent, report utilizing some kind of tax benefit covered under the extenders umbrella.	

Which of the following deductions or credits do you think are most important to stimulating small-business growth? (check all that apply)	
Allow full deduction for health insurance costs for self-employed	62%
Sec. 179 expensing	36%
Start-up costs deduction	32%
Bonus depreciation	31%
Home mortgage interest deduction	25%
Work Opportunity Tax Credit	25%
Home office deduction	22%
15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and qualified retail improvements	22%
R&E tax credit	17%
Energy efficiency credits	17%
Other	17%

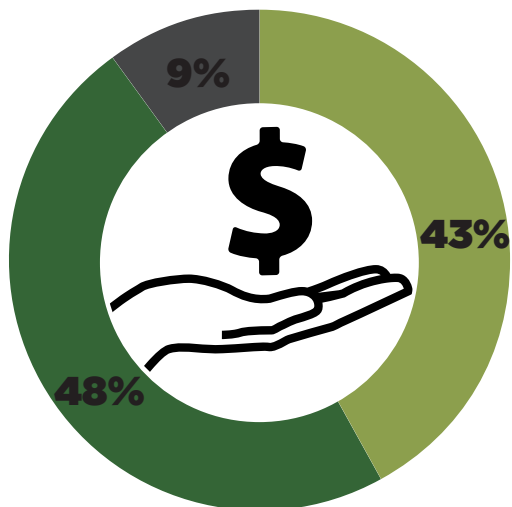


ACCOUNTING & INVENTORY

Providing flexibility and simplicity to small businesses in which method of accounting they use for tax purposes is important. Cash accounting—widely seen as a simpler, more straightforward method of accounting—is utilized by 48 percent of small businesses. Among the 46 percent of survey respondents who report having inventory, 14 percent utilize Last-in, First-out (LIFO), 32 percent utilize Specific Identification Method and 34 percent utilize First-in, First-out (FIFO).

Which method of accounting does your business utilize?

■ Accrual ■ Cash ■ Not Sure



Do you have inventory for your business?

■ Yes ■ No



“ Nearly half of small firms utilize cash accounting as a simpler, more straightforward method for their firms. ”

Which method do you use for purposes of determining your company's inventory cost?

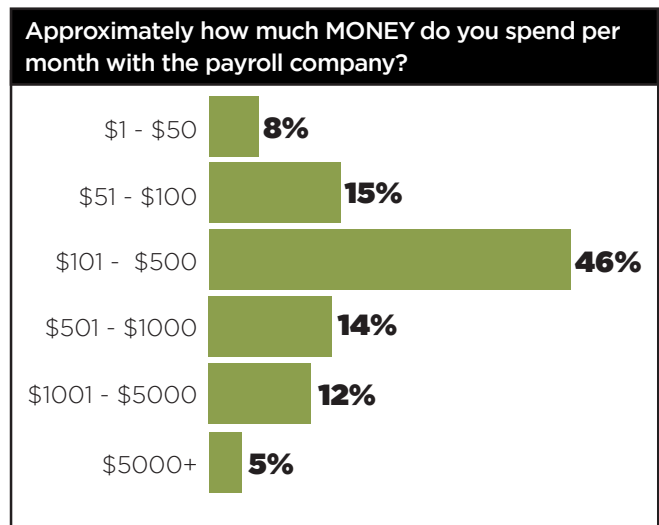
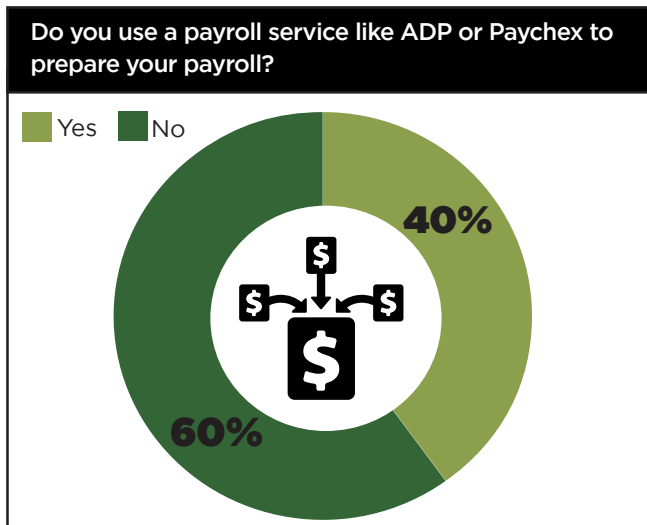


PAYROLL

Payroll taxes were ranked as the number one most financially burdensome and number two most administratively burdensome federal tax among small firms. The complexity of payroll taxes is a likely driver of the fact that the majority of firms with more than 5 employees use an external payroll company. One-in-three small firms report spending more than \$500 per month on payroll services – this amounts to more than \$6,000 per year.

Among those small businesses who handle payroll taxes internally, 27 percent report spending more than six hours per month and one-in-ten report spending more than 10 hours per month.

While 10 hours per month may not sound overly burdensome, it amounts to more than 120 hours per year, or three full work weeks.



Even if you pay an outside payroll company, please estimate the amount of time you spend on the administration of payroll taxes?

No time - I have no employees	2%
1 to 2 hours per month	41%
3 to 5 hours per month	29%
6 to 10 hours per month	15%
More than 10 hours per month	14%

If you handle payroll internally, approximately how much time do you spend on the administration of payroll taxes?

No time - I have no employees	21%
1 to 2 hours per month	26%
3 to 5 hours per month	26%
6 to 10 hours per month	17%
More than 10 hours per month	11%

“The majority of firms with more than five employees have to outsource their payroll to another company.”

SALES TAX

While nearly half of small businesses report they don't collect sales taxes—likely due to the high proportion of professional services, construction and manufacturing businesses among the respondents—27 percent report spending three hours or more per month on the administration of sales taxes. Again, taken just per-month it may not sound like a significant burden, but taken over the entirety of the year, it amounts to nearly one full work week.

The survey results underscore the divide among small-business owners when it comes to proposals to mandate sales tax collection of online purchases by small firms. Forty-one percent of small-business owners—even those who do not currently have any online transactions—would support some kind of requirement with varying degrees of exemptions and/or safe-harbor protections for the firm. Fifty-one percent oppose any kind of requirement.

When it comes to mandating sales tax collection on online purchases, the biggest concerns expressed by small businesses had to do with complexity and the resulting potential for tax liability. Considering the massive web of state, county, city and municipality sales tax rules, it's no wonder the most significant concerns were navigating various state tax rules and keeping abreast of changes.

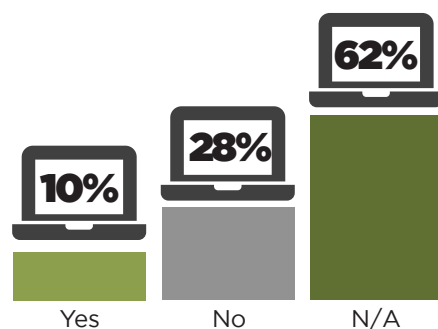
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While 10 hours per month may not sound overly burdensome, it amounts to more than 120 hours per year, or three full work weeks.

Approximately how much time does your company spend on the administration of sales taxes?



Do you collect sales tax on transactions conducted online?



Would you support a requirement that all companies be subject to state sales taxes, even if that company is located in a different state and all sales are online?

Yes, if the states' sales tax systems were streamlined or simplified	21%
Yes, with an exemption for companies with less than \$1 million in annual revenue	8%
Yes, with an exemption for companies with less than \$5 million in annual revenue	4%
Yes, with an exemption for companies with less than \$10 million in annual revenue	3%
Yes, with an exemption for companies with less than \$30 million in annual revenue	1%
Yes, with no exemptions	5%
No	51%
Not Sure	16%

Please indicate how significant a burden each of the following issues is when it comes to small firms collecting online, multi-state sales tax.

	Significant concern	Moderate concern	Not a concern
Cost of software to calculate sales tax	38%	28%	34%
Reliability of software to calculate sales tax	36%	27%	37%
Threat of tax liability in case of inadvertent errors	52%	24%	25%
Threat of increased audits	49%	26%	24%
Navigating various state tax rules and deadlines	61%	18%	21%
Keeping abreast of various state tax changes (incl. rate and deadline changes)	60%	19%	21%
Appropriate holding and disbursement of collected sales tax	47%	24%	28%

TAX POLICY

As voted on by NSBA's members at the biennial Small Business Congress, deficit reduction through tax, spending and entitlement reform is NSBA's **number one priority** for the 113th Congress.

Given that the majority of small businesses are pass-through entities, there was overwhelming support, 67 percent, for tax reform that would reduce both corporate and individual tax rates coupled with a reduction in business and individual deductions. Underscoring the huge headache tax complexity poses, the majority of small firms support the Fair Tax—a national 23 percent tax on the end point-of-sale for all goods that would replace all current individual and corporate tax schemes.

As NSBA has been warning for quite some time, addressing just one piece of the puzzle to effectively reduce the deficit—such as corporate tax reform alone—without all pieces will lead to even greater complexity and a massive tipping of the scales in favor of the nation's largest companies at the expense of small businesses.

Please indicate your level of support for each of the following tax reform proposals



SUPPORT



DON'T SUPPORT



NOT SURE

Reduce both corporate and individual tax rates, and reduce both business and individual deductions	67%	19%	14%
A broad reform of the tax system in-line with the Fair Tax (elimination of all income and corporate tax rates as well as all deductions, and instead implement a 23 percent tax on the end point-of-sale for all goods)	53%	25%	22%
Reduce the corporate tax rate and eliminate some business deductions	47%	23%	29%
Moving the current U.S. tax system from a "worldwide" tax system, in which all income is taxed regardless of its origin, to a "territorial" system, in which all foreign-source income is exempted from tax	18%	50%	32%
A European type value added tax	11%	50%	39%

“ Small firms overwhelmingly support broad tax reform that that would reduce both corporate and individual tax rates, and reduce deductions. ”

Please indicate your level of support for each of the following deficit-reducing proposals do you support?



SUPPORT



DON'T SUPPORT



NOT SURE

Reform and reduce entitlement spending	76%	13%	11%
An across-the-board budget cut for federal agencies	66%	27%	8%
Eliminate all tax credits and deductions in conjunction with dramatically lower income tax rates	58%	25%	17%
Eliminate certain tax credits and deductions—even those which may benefit my business	46%	31%	23%
Greater authority of the president to reduce Congressionally-approved spending (line-item veto)	36%	49%	15%
Raise taxes on the highest-earning individuals	34%	55%	11%

NSBA TAX REFORM CHECKLIST

SMALL BUSINESS NEEDS TAX REFORM NOW!

PRINCIPLES OF TAX REFORM

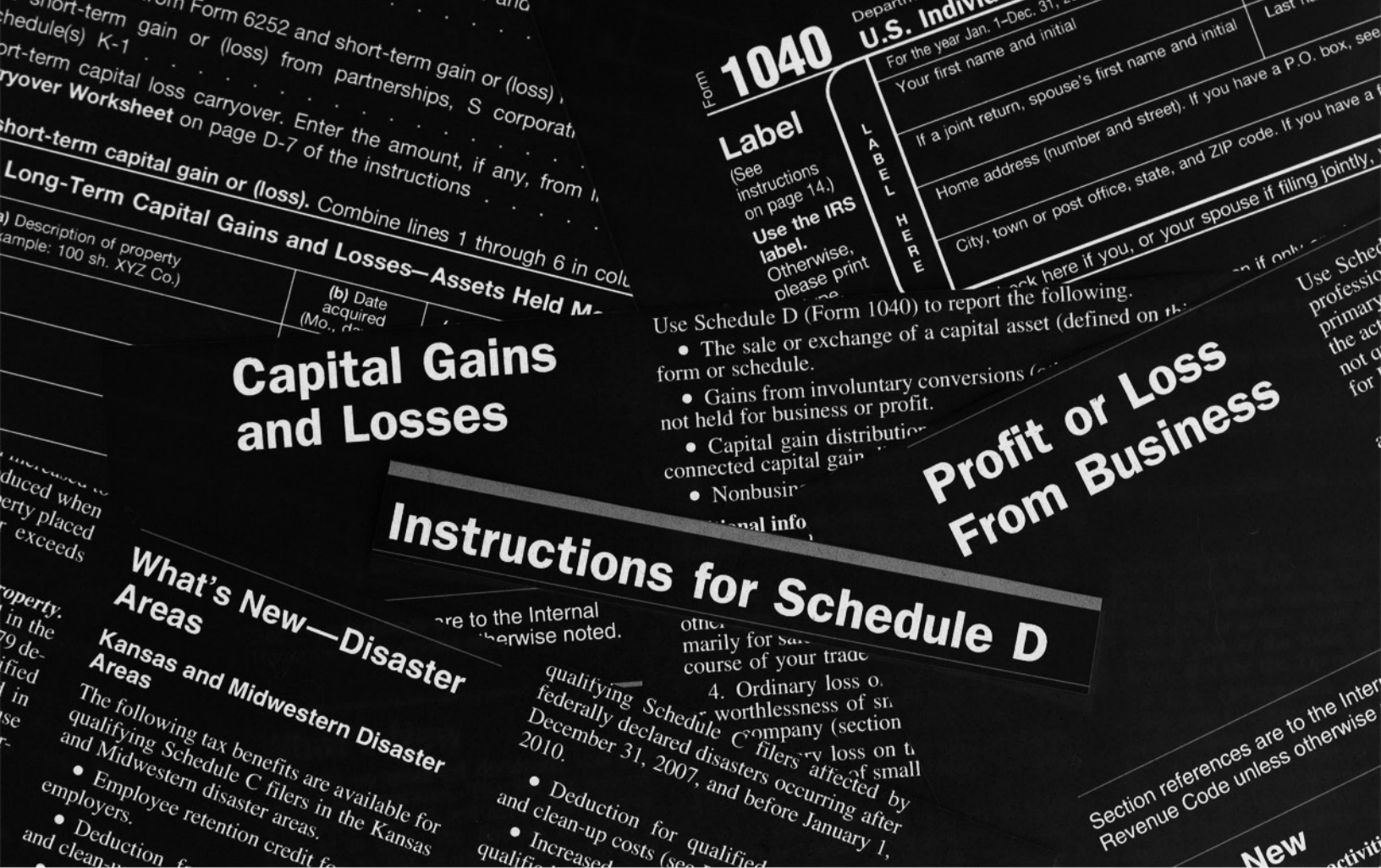
- ✓ **DESIGNED TO TAX ONLY ONCE**
- ✓ **STABLE AND PREDICTABLE**
- ✓ **VISIBLE TO THE TAXPAYER**
- ✓ **SIMPLE IN ITS ADMINISTRATION AND COMPLIANCE**
- ✓ **PROMOTE ECONOMIC GROWTH AND FAIRNESS BETWEEN LARGE & SMALL BUSINESSES**
- ✓ **USE COMMONLY UNDERSTOOD FINANCE/ ACCOUNTING CONCEPTS**
- ✓ **GROUNDING IN REALITY-BASED REVENUE ESTIMATES**
- ✓ **FAIR IN ITS TREATMENT OF ALL CITIZENS**
- ✓ **TRANSPARENT**

The tax code is inherently unfair to small businesses, and the time for serious tax reform has come. Weighing in at more than 70,000 pages, the U.S. Tax Code punishes work, investment, risk-taking and entrepreneurship.

America's small-business owners have consistently ranked "tax reform" among the top issues for Congress to address, yet our elected officials continue to prioritize scoring political points over passing sound policy, especially when it comes to tax reform.

We need tax reform and we need it now.

NSBA
National Small Business Association



METHODOLOGY

The 2014 Small Business Taxation Survey was conducted on-line March 18-28 among more than 1,100 small-business owners representing every industry in every state in the nation. The small business respondents represent both NSBA members—which tend to be older, more well-established small businesses—as well as nonmembers.

