NSBA 2014 SMALL BUSINESS TAXATION SURVEY
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.
DEMOGRAPHICS

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

- 0: 7%
- 1 to 4: 35%
- 5 to 9: 18%
- 10 to 19: 17%
- 20 to 99: 19%
- 100 to 499: 4%
- N/A: 5%

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): 12%
- 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.

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

- Less than $100,000: 12%
- $100,000 - $250,000: 11%
- $250,000 - $500,000: 12%
- $500,000 - $1 Million: 15%
- $1 - $5 Million: 28%
- $5 - $10 Million: 9%
- $10 - $15 Million: 4%
- $15 - $20 Million: 2%
- $20 - $25 Million: 2%
- $25 - $75 Million: 3%
- $75 - $150 Million: 1%
- $150 Million+: 2%
- N/A: 2%

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

- Less than $100,000: 12%
- $100,000 - $250,000: 11%
- $250,000 - $500,000: 12%
- $500,000 - $1 Million: 15%
- $1 - $5 Million: 28%
- $5 - $10 Million: 9%
- $10 - $15 Million: 4%
- $15 - $20 Million: 2%
- $20 - $25 Million: 2%
- $25 - $75 Million: 3%
- $75 - $150 Million: 1%
- $150 Million+: 2%
- N/A: 2%

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

- Less than $100,000: 25%
- $100,000 - $500,000: 34%
- $500,001 to $1 million: 16%
- $1 - $5 Million: 18%
- $5 - $25 Million: 3%
- $25 - $75 Million: 0%
- $75 - $150 Million: 0%
- $150 Million+: 0%

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

- Less than $500,000: 37%
- $500,000 - $1 Million: 17%
- $1 - $2 Million: 15%
- $2 - $3.5 Million: 9%
- $3.6 - $5 Million: 7%
- $5 - $7.5 Million: 4%
- $7.5 Million+: 7%
- N/A: 4%

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.
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.

What is your estimated time spent dealing with federal taxes each year? (For example, calculating payroll, self-employment or any other business-related tax, filing reports, working with your accountant, estate planning, etc...?)

- 1 to 10 hours: 14%
- 11 to 20 hours: 14%
- 21 to 40 hours: 15%
- 41 to 80 hours: 18%
- 81 to 120 hours: 16%
- 120 hours +: 24%

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...)?

- Less than $500: 12%
- $501 to $1,000: 11%
- $1,001 to $5,000: 31%
- $5,001 to $10,000: 18%
- $10,001 to $20,000: 12%
- $20,001 to $40,000: 9%
- More than $40,000: 7%

How do you prepare your taxes?

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

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

### How much of an impact would you say federal taxes have on the day-to-day operation of your business?

- Significant impact: 34%
- Small impact: 39%
- Moderate impact: 18%
- No impact: 9%

### How much do tax credits and/or deductions influence your decisions about your company and/or employees?

- Significantly: 27%
- Modestly: 32%
- A Little: 16%
- Not at all: 25%

### 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%
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).

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

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.

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.

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

- 49% No time - I don't collect sales tax
- 23% 1 to 2 hours per month
- 16% 3 to 5 hours per month
- 7% 6 to 10 hours per month
- 4% 10 hours +

### Do you collect sales tax on transactions conducted online?

- 10% Yes
- 28% No
- 62% N/A

### 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.

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

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Support</th>
<th>Don’t Support</th>
<th>Not Sure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce both corporate and individual tax rates, and reduce both business and individual deductions</td>
<td>67%</td>
<td>19%</td>
<td>14%</td>
</tr>
<tr>
<td>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)</td>
<td>53%</td>
<td>25%</td>
<td>22%</td>
</tr>
<tr>
<td>Reduce the corporate tax rate and eliminate some business deductions</td>
<td>47%</td>
<td>23%</td>
<td>29%</td>
</tr>
<tr>
<td>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</td>
<td>18%</td>
<td>50%</td>
<td>32%</td>
</tr>
<tr>
<td>A European type value added tax</td>
<td>11%</td>
<td>50%</td>
<td>39%</td>
</tr>
</tbody>
</table>

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?

<table>
<thead>
<tr>
<th>Proposal</th>
<th>Support</th>
<th>Don’t Support</th>
<th>Not Sure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reform and reduce entitlement spending</td>
<td>76%</td>
<td>13%</td>
<td>11%</td>
</tr>
<tr>
<td>An across-the-board budget cut for federal agencies</td>
<td>66%</td>
<td>27%</td>
<td>8%</td>
</tr>
<tr>
<td>Eliminate all tax credits and deductions in conjunction with dramatically lower income tax rates</td>
<td>58%</td>
<td>25%</td>
<td>17%</td>
</tr>
<tr>
<td>Eliminate certain tax credits and deductions—even those which may benefit my business</td>
<td>46%</td>
<td>31%</td>
<td>23%</td>
</tr>
<tr>
<td>Greater authority of the president to reduce Congressionally-approved spending (line-item veto)</td>
<td>36%</td>
<td>49%</td>
<td>15%</td>
</tr>
<tr>
<td>Raise taxes on the highest-earning individuals</td>
<td>34%</td>
<td>55%</td>
<td>11%</td>
</tr>
</tbody>
</table>
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
- Grounded 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.
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.