

# **The Market for Small Business Tax Education: An Exploratory Study**

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## **ABSTRACT**

*This study was based on the premise that small business owners are interested in acquiring tax knowledge. Data were collected from a sample of 500 small business owners located in a Southern city in 1993. While independent accountants provide tax compliance services and expertise, small business owners who lack basic tax knowledge may be interested in acquiring such knowledge because it might lead to tax savings for their business. The findings reveal that the small business owners' desire for tax education may be moderated by years of experience. Furthermore, most small business owners were unwilling to incur out of pocket expenses for tax education. The market for providing tax education to small business owners appears to be an elusive one which may require a great deal of creativity to stimulate.*

## **INTRODUCTION**

According to the U.S. Small Business Administration Office of Advocacy (1994), the number of small businesses in the United States has increased 49% since 1982. In 1993, there were approximately 21.5 million small (nonfarm) businesses, of which 99% had fewer than 500 employees (U.S. Small Business Office of Advocacy, 1994). In addition, the number of new small businesses has increased steadily during the past 30 years. There were 666,800 new small businesses recorded during 1992 (U.S. Small Business Office of Advocacy, 1994).

Small businesses create many new jobs and are an important part of our nation's economic growth. In 1993, small businesses employed 54% of the private work-force, contributed 52% of all sales in the country, and were responsible for 50% of the private gross domestic product. Seventy-one percent of the 1.9 million new jobs created during 1993 were produced by small businesses (U.S. Small Business Administration Office of Advocacy, 1994). Thus, small businesses are important to the U.S. economy.

Businesses are a major source of tax revenue. In the tax system, businesses play the dual roles of agent and debtor. As an agent, a business withholds and pays taxes such as social security (FICA) and unemployment (FUTA) for its employees. As a debtor, a business pays taxes such as income and franchise for which it is directly liable. However, the current tax system is complex and tax compliance is a complicated job. The routine tax matters of large businesses are met by their in-house tax departments. Additional tax support comes from international accounting firms. In contrast, small businesses rely primarily on local tax experts for assistance in complying with the tax laws and may resort to a self-help approach. That is, they may supplement the assistance of local experts by acquiring their own knowledge. This may be accomplished by attending short courses or seminars and by consulting tax articles, pamphlets, and books.

The purpose of this research is to explore the market for tax education for small businesses. Three research questions were identified:

- (1) Is the small business owner's interest in acquiring tax education impacted by years of experience?
- (2) Is better knowledge of tax important to small business owners because it translates into tax savings and better business decisions?
- (3) Are small business owners willing to make out of pocket payment for tax education?

Several criteria have been used to define a small business, such as the type of business, the number of employees, and the dollar value. The most widely used criterion is the number of people on the payroll. The Small Business Administration has formulated size standards according to the number of employees and sales volume. The definition adhered to in this study is that a small business is one with 500 or fewer employees.

## LITERATURE REVIEW

A review of the recent research on small business revealed about eight research streams. Recent research has addressed the financial reporting and analysis practices of small businesses (cf. McMahon & Davies, 1994; Coker & Hayes, 1992), international strategies of small business (cf. Baird, Lyles & Orris, 1994; Wright, 1993), and long-term entrepreneurship patterns (Dolinsky, Caputo & Pasumarty, 1994).

A myriad of articles have addressed the performance of small businesses (e.g. Chowdhury & Lang, 1993; Dyke, Fischer & Reuber 1992; Dadzie & Cho, 1989), planning and decision making in small businesses (cf. Humphreys, Robin, Reidenbach & Moak, 1993; Davig & Brown, 1992) and the problems of small businesses (Taylor & Banks, 1992; Price, 1992).

Hardly any research was identified that addresses the topic of small business and taxation issues. The very limited published research on small business and taxation deals with tax reform (Neeley, 1992) and tax return preparation services (Dubin, Graetz, Udell & Wilde, 1992; Hite, Stock & Cloyd, 1992).

The researchers found only one article that addressed the issue of small business and tax education. In that article, Price (1992) focused on minority-owned small businesses and revealed a low awareness of the IRS Small Business Tax Education Program (STEP). He concluded that the low awareness rate for STEP indicates that the IRS has failed to make the respondents of his study aware of a service that could significantly enhance their ability to comply with Federal tax laws.

## RESEARCH DESIGN

### *The sample*

Data were collected from a sample of 500 small business owners located in a Southern city in 1993. The sample frames consisted of a 1992 roster of certified Minority and Women Business Enterprises (MWBE) and the listing of small businesses by SIC codes in the 1993 Dun and Bradstreet Marketing Information.

### *The questionnaire*

The questionnaire was designed to collect several types of information. In the first section, general information was sought concerning the line of business, business form, and number of employees. Respondents were also asked to identify the type and use of tax service providers.

In the second part, respondents were asked to evaluate the benefits of tax education to their businesses. Respondents were also asked about their use of tax software packages and whether the use of such software packages reduced their need for tax education. A five-point scale (with descriptive anchors) was employed for evaluation purposes, with the possible ratings ranging from 5 for "strongly agree" to 1 for "strongly disagree." Respondents were also asked about their awareness of available tax education programs and their willingness to attend and pay for such education.

The third part of the questionnaire elicited personal information about the owner including position, ethnicity, years of experience and formal educational background.

### *Data collection*

Data collection occurred during the winter of 1993. The target sample consisted of 500 small business owners in a Southern city. The Total Design Method of Dillman (1978) was followed in an effort to enhance response to the questionnaire. A hand-signed cover letter explaining the study and encouraging participation accompanied the questionnaire. Of the 500 questionnaires mailed, 200 did not reach the intended individuals due to changed addresses without forwarding information and 170 were not returned, thereby reducing the effective sample to 130. Of the 130 returned questionnaires, 16 were not eligible because of missing data, leaving 114 usable questionnaires. The somewhat low response rate (22.9%) may be attributed to the large number of unforwardable addresses and the timing of the mailing (November). Nonetheless, the rate of response was comparable to that of other similar studies (cf. Dadzie & Cho, 1989).

The majority (74%) of the sample were white, with only 16% black, 2% Hispanic and 1% Asian. Eighty-four respondents (74%) were the chief executive officer of the company.

Almost one-half (46%) of the respondents had more than twenty years of experience in their business. Respondents with one to ten years of experience represented 24% of the sample. Those with 11 to 20 years represented 30%.

A profile of the respondents is shown in Table 1. Most of the responses were from owners of service (33%) and construction (18.3%) firms. More than 60% of the respondents were college graduates.

**Table 1: Profile of Respondents**

	(Percent)		(Percent)
<b><u>Industry/Line of Business:</u></b>		<b><u>Size of Respondent's Business:</u></b>	
Construction	18.3	(Number of Paid Employees)	
Finance/Insurance	0.9	Self Only	14.5
Manufacturing	12.8	1-10	51.8
Real Estate	5.5	11-20	12.7
Service	33.0	21-30	4.5
Retailing	9.2	31-50	3.6
Wholesaling	4.7	Over 50	12.7
Transportation/Communication	5.5		
		<b><u>Ethnic Origin of Entrepreneur:</u></b>	
		Black/African-American	17.00
		Asian	9.0
		Hispanic	1.9
		Caucasian	79.2
<b><u>Type of Business Organization:</u></b>		<b><u>Years of Experience in Business:</u></b>	
Sole Proprietorship	21.1	1-55	5.3
Corporation	45.9	6-10	18.4
S-Corporation	27.5	11-15	15.8
Partnership	2.8	16-20	14.5
Professional Corporation	2.8	Over 20	46.1
		<b><u>Educational Level of Respondent:</u></b>	
<b><u>Title of Respondent:</u></b>		H.S. Graduate	13.2
Chief Operating Officer	78.0	Some College	21.1
Manager	8.0	College Graduate	34.2
Other (President, Controller, Treasurer)	14.0	Post-College	31.6

## ANALYSIS & RESULTS

### *Years of experience and interest in tax education*

The presumption was that the longer the small business owner has been in business, the greater the interest in acquiring tax education. The responses of small business owners grouped by years of experience were compared using cross tabulation (frequency) analysis. The respondents were classified into three categories: young (1-10 years of experience), middle-aged (11-20 years of experience) and experienced (over 20 years of experience). The rationale for using years of experience was based on the premise that business owners with more years of experience have had more exposure to tax compliance issues and frequent tax law changes than business owners with less experience. Presumably the success or failure of a business depends not only upon the owner's business experience but upon the owner's ability

to control the financial affairs of the business as well. Control over the financial affairs would mean making meaningful and informed decisions regarding tax compliance and tax planning issues.

Responses to questions dealing with the amount of time that respondents are willing to devote to tax education, if they have ever paid to attend a tax seminar, and if they have ever attended a free tax workshop for small businesses were analyzed. The researchers assumed that positive responses to the aforementioned issues would indicate the owners' interest in acquiring tax knowledge. The results are summarized in Tables 2 and 3.

Those small business owners with over 20 years of experience have a greater interest in acquiring tax knowledge when compared to those with fewer years of experience. Furthermore, most had never paid to attend a tax workshop nor had they ever attended a free tax workshop.

While it is beyond the scope of this research to determine the reasons for their lack of attendance at tax workshops, this occurrence may be partly explained by the low levels of awareness. For example, 50% of the respondents were not aware that there are free tax education programs for small businesses.

**Table 2: Years of Experience & Interest in Acquiring Tax Education**

<u>Type of Interest</u>	<u>N</u>	<u>Years of Experience</u>	<u>Number</u>	
			<u>Yes</u>	<u>No</u>
Attended Free Workshop	109	1-10	3	21
		11-20	4	11
		Over 20	8	62
Attended Paid Workshop	109	1-10	1	23
		11-20	1	14
		Over 20	7	63
Willing To Pay	100	1-10	8	16
		11-20	4	9
		Over 20	25	38

**Table 3: Time Willing to Devote to Tax Education**

<u>TIME</u>	<u>Years of Experience</u>			<u>Total</u>
	1-10 <i>n</i> =18	11-20 <i>n</i> =20	Over 20 <i>n</i> =50	
1-4 hours	10	9	24	43
5-8 hours	2	1	7	10
several weeks	6	2	14	22
not sure	0	0	1	1
none	0	1	4	5

### *Importance of increased tax knowledge and compliance*

The researchers sought to provide empirical evidence supporting the premise that owners believe that a better knowledge of tax laws will enhance their ability to comply with tax laws. Compliance fosters tax savings, which can best be achieved when good communications exist between a business owner and his or her accountant. The quality of the overall business decisions made by the owner will also improve as a natural by-product of his or her enhanced tax knowledge.

Perceived importance of tax knowledge was measured by assessing respondents' agreement with the following statements:

- A better knowledge of tax laws would save me money.
- A better knowledge of the tax laws would enhance my ability to communicate effectively with my accountant.
- A better knowledge of tax laws would enhance my ability to make better decisions regarding my business.
- Keeping track of paying federal income taxes is a complicated job that requires the help of a paid professional.

To explore the premise stated above, responses to five-point Likert scaled (1=strongly disagree, 2=disagree, 3=not sure, 4=agree, 5=strongly agree) questions were assessed using analysis of variance. The importance of tax knowledge statements served as the dependent variable and years of experience served as the independent variable in the ANOVA and MANOVA tests. The ANOVA and MANOVA tests did not result in significant findings.

### *Willingness to pay for tax education*

Price (1992) conducted research on the problems and needs of minority-owned small businesses. He found that minority owners of small businesses are aware of the complexity of the federal tax law and the availability of the Internal Revenue Service's STEP program (Small Business Tax Education Program), which is designed to assist small business owners; however, these owners did not make use of this service.

Price's (1992) research did not address the question of whether these and other small business owners are willing to make monetary concessions in order to enhance their ability to comply with tax laws. The willingness of small business owners to incur out of pocket expense for tax education was examined in the present study using cross tabulation (frequency) analysis.

The majority of the respondents (62.7%) were not willing to incur out of pocket expense for tax education. While the majority of respondents were unwilling to pay for tax education, those that were can be described in terms of their years of experience, business organization, and education. Namely, 43.8% of those respondents with more than 20 years of experience indicated their willingness to pay for tax education. Forty-five percent of those whose small businesses were C-corporations indicated their willingness to pay. Fifty-five percent of respondents with more than a college education indicated their willingness to pay for tax education.

## DISCUSSION

### *Anticipated findings*

As expected, small business owners with many years of experience had a greater interest in acquiring tax knowledge than did small business owners with fewer years of experience. Small business owners with many years of experience are likely to be more economically stable and able to afford the time.

Most (90%) of the respondents used a paid tax preparer; 74% of the paid tax preparers were CPAs. Ninety-two percent (92%) of the respondents indicated that a paid preparer was used because he/she was more knowledgeable regarding tax matters. Yet, it appears that experienced owners may desire meaningful input into tax decisions. Hite (1992) indicated that small business owners desired control over their tax reporting activity. The results of this study seem to support her finding. The majority of respondents (55%) were unaware of tax workshops for small businesses, a finding somewhat anticipated based upon Price's (1992) research. Price found that many minority-owned small business people were unaware of the Small Business Tax Education Program (STEP) sponsored by the IRS. Price attributed the lack of awareness to the IRS's failure to adequately promote the STEP program. A similar conclusion was reached in this study.

### *Unanticipated findings*

Contrary to the researchers' expectations, most small business owners were unwilling to pay for tax education. In light of the overwhelming use of paid professionals by respondents, it is reasonable to assume that respondents perceive that they are paying for tax knowledge indirectly by employing a paid professional. By employing an accountant, they are receiving the benefit of the professional's knowledge, at no additional cost to the business.

Another explanation relates to the nature of tax education offered to small business owners in the past. Historically, tax education for small business owners has been offered as a free service by the Internal Revenue Service and the Small Business Administration. Small business owners may not be willing to pay for services or programs that they perceive can be offered by these agencies at no cost.

A final explanation may be based on the allocation of the businesses' limited resources. Small business owners may decide to use scarce but discretionary funds of their businesses for more productive activities rather than for educational activities.

The question regarding the use of software packages provided little additional insight. A majority (52%) of respondents were not sure that the use of software (such as Turbo Tax) for tax preparation would reduce the need to understand tax laws. This uncertainty may stem from the small business owner's lack of exposure to and use of tax software inasmuch as the tax return is prepared by someone outside of the business.

## MANAGERIAL IMPLICATIONS

The study has several managerial implications. The data can be used to fine-tune specific aspects of overall marketing strategy for existing small business tax workshops and for seminars sponsored by the IRS and the SBA.

The study suggests that small business owners with more than 20 years experience may have a greater interest in acquiring tax knowledge when compared to small business owners with less experience. In addition, 44% of this segment were willing to incur out of pocket expenses to attend a tax seminar. Tax

workshops and seminars offered by the IRS and others may be using a mass marketing approach. That is, no specific targets within the small business community have been identified. The market for tax workshops and seminars could possibly be segmented by years of experience. Another possible basis for segmentation could be by type of business organization.

Many respondents seem to believe that enhanced tax education is of particular importance because such knowledge allows them to better understand tax and accounting information presented by their tax professional. This finding may provide valuable information for the design of an appropriate message strategy to use when promoting such programs. For example, in advertising and promoting tax educational seminars, emphasis could be placed on how information presented by tax accountants could be better understood. The finding may also stimulate the IRS and other organizations (e.g., SBA) that provide tax education to small businesses to reassess their promotional strategies.

More than 50% of respondents were not aware of free tax workshops. Clearly providers of these seminars must better identify the appropriate media to use in order to reach small business owners. By including a question on a seminar evaluation instrument such as, "How did you find out about this seminar?" and by conducting a survey of media usage by small business owners, providers might gain information that could result in more effective and efficient promotional programs.

Small business owners are unwilling to incur out of pocket expenses to attend tax seminars; however, such information may be used to capitalize on a promotional inducement opportunity. Namely, providers of such seminars might offer "two or three part" seminars, instead of a "one shot" seminar. The first "part" could be offered at no cost to attendees. Subsequent parts could be offered on a fee basis. Of course, the first "part" must thoroughly whet the appetite of the attendees and induce them to attend the other part(s).

Computerized tax preparation packages are readily available on the market. While mostly used by tax preparers and individuals, a larger market may exist for these packages if such packages are specifically tailored and targeted to small business owners.

## DIRECTIONS FOR FUTURE RESEARCH

It is hoped that this research will serve as an allurements to investigate further small business tax and other education issues. Future research should endeavor to determine why so many small business owners are unaware of the free tax programs offered by the IRS and SBA and what the appropriate content, timing and format for such programs should be.

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