2006

Private Enterprise Job Creation in the Midwest: Does Size Matter?

Hedayeh Samavati
Indiana University - Purdue University Fort Wayne, samavati@ipfw.edu

Carolyn F. Stumph
Indiana University - Purdue University Fort Wayne, stumphc@ipfw.edu

Follow this and additional works at: http://opus.ipfw.edu/econ_facpubs

Part of the Economics Commons

Opus Citation
http://opus.ipfw.edu/econ_facpubs/24

This Article is brought to you for free and open access by the Department of Economics at Opus: Research & Creativity at IPFW. It has been accepted for inclusion in Economics Faculty Publications by an authorized administrator of Opus: Research & Creativity at IPFW. For more information, please contact admin@lib.ipfw.edu.
Private Enterprise Job Creation in the Midwest: Does Size Matter?

As policymakers search for ways to keep jobs in the United States and stem the drain of outsourcing, researchers once again return to the question of which type of business has been responsible for the majority of the jobs created in recent years? In other words, how can we leverage policy initiatives in ways which make a substantive difference in peoples’ employment opportunities? This study examines the recent job creation experience of the Midwest region. The results suggest that for each of the eight states that comprise the Midwest region, small businesses were a more potent engine for job creation than large businesses. The analysis also indicates that business taxes and educational attainment in a state were significant determinants of the number of jobs created. The implications of these findings are that priority should be given to small businesses when tax cuts are used to promote economic development. In addition, a public policy that aims to promote education will uniquely benefit small businesses and should thus be considered as a job creation policy.

By: Hedayeh Samavati and Carolyn Fabian Stumph

ACKNOWLEDGMENT: The authors wish to thank Professor David A. Dilts for his helpful comments. Naturally, any remaining errors are the responsibility of the authors.

I. Introduction

In July of 2004, the House of Representatives devoted substantial legislative effort to the issue of America’s global competitiveness. The House addressed eight topics considered key to the success of American business. These topics were: the cost of health care, bureaucracy, education, energy, innovation, international trade, taxes and tort reform. These initiatives were designed to help both large and small businesses alike (Roy, S. and J. Grella, 2004).

The primary concern of policymakers during the previous year had been America’s jobless recovery. In order to increase profits and bolster stock prices, firms sought ways to reduce labor costs through downsizing, outsourcing and reducing employee benefits. The result of these actions was an increase in corporate profits which was not passed on to workers, but was instead retained by corporate owners (Bivens, 2003). Moreover, the manufacturing sector which currently accounts for about eleven percent of U.S. business sector employment (down from 15% at the beginning of 1995), suffered job losses that were unprecedented relative to historical standards. According to the Bureau of Labor Statistics, by the end of fourth quarter of 2003, hours of all persons in manufacturing had fallen for fourteen consecutive quarters. February 2004 marked the 57th month over which the manufacturing sector experienced job losses. In 2004, the unemployment rate for persons most recently employed in manufacturing industries was 5.7% as compared to an overall unemployment rate for the economy of 5.5%. Furthermore, the Bureau of Labor Statistics predicts that manufacturing employment will drop an additional one percent over the next seven years (BLS, Industry at a Glance: Manufacturing, August 2005).

![Employment in manufacturing, 1995 - 2004](image)


Manufacturing positions are usually, but not always, generated by larger businesses due to the economies of scale enjoyed in their production processes. In this dynamic phase of worker reallocation, a pivotal question for researchers becomes which businesses, small or large, can be counted upon to provide the bulk of jobs that need to be created? In other words, should small businesses be the target of additional support by policy makers or should large businesses receive the benefits of favorable policy actions? If small businesses are found to be a significant source of regional job creation, then it might be justifiable to divert resources so that efforts can be made to help them overcome the hurdles to successful development.
While most believe that small businesses are the fountainhead of job creation, there are those who caution that it is the quality and not the quantity of jobs that should be the objective of economic policy (Zipp, 1991 and Perkins, 1994). Therefore, large businesses, especially those in the manufacturing sectors, should not be overlooked if promoting quality employment is the objective of policymakers.

The purpose of this paper is to examine the data on job creation by both small and large businesses in the Midwestern states, namely, Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Ohio, and Wisconsin. It seeks to understand the role of small and large private enterprise in job creation in the Midwest.

In seeking the answers to questions raised regarding job creation, one approach may be to examine the data for the entire United States; the other is to closely look at regional data, an approach which is chosen in the current study. One justification for this approach is that the states in each region (e.g., Midwest, Southwest, Northeast, etc.), may share commonalities in terms of economic structure and similarities in terms of cultural values and attitudes which may prove to be significant factors affecting their respective business environments. Regional study may help reveal factors that are pertinent to the economic vitality of one region, but not the others. Furthermore, as an additional advantage, regional studies provide opportunities for comparing and contrasting the findings which may lead to deeper insights about the issues being investigated. The next section offers a brief review of the literature.

II. Literature Review

The role of small and large businesses in the economic life of the country has been the subject of intense debate. While it seems that the big business usually gets its dues as evidenced by the celebration of Fortune 500 and the publicity around such businesses, small businesses enjoy a special place in American culture.

The results of a recent poll conducted by the National Federation of Independent Business, published in the October 5, 2004 issue of the Wall Street Journal, revealed the institution of small business occupied a revered place in the American psyche.

It is hardly a revelation to unveil the results that indicate small businesses are well-respected in the society. However, it may come as a surprise, at least to some, to discover that small businesses were perceived to have a positive influence on the country with a larger percentage than that for the colleges/universities and the religious organizations; 78%, 76%, and 66%, respectively. Given the results, Breeden (2004) concluded that Most Americans believe small businesses have a positive impact on the country as a whole.

While conventional wisdom presumes that four out of five new businesses will fail within the first five years, Phillips and Kirchhoff (1989) found that survival rates for small businesses are not as dismal as it is commonly believed. Using a data set developed by the U.S. Small Business Administration, these authors reported a failure rate of three out of five, a rate that is 20% below the commonly believed failure rate for small businesses. However, recent data show that approximately 34% of new firms with employees will not weather the first two years (Ramachandran, 2004).

Other studies have shown that size is not totally irrelevant when it comes to the success of a business. For example, Headd (2003) reported that for employer firms having a starting capital greater than $50,000 and the entrepreneur starting the business having a college degree increased the likelihood of survival. Moreover, Headd (2003) concluded that, Overall, results tended to support the hypothesis: having the resources to be or get larger and the motivation to persist leads to survival. (Headd, 2003, p. 56).

There is not a consensus among academicians concerning the economic impact of small businesses and their contribution to the overall growth of jobs in the country. In a study conducted by Davis, Haltiwanger, and Schuh (1996) the authors arrived at the conclusion that small businesses are no better than big businesses when it comes to the question of job creation. They suggested that, Conventional wisdom about the job creating prowess of small businesses rests on statistical fallacies and misleading interpretations of the data. (p. 57). These authors particularly questioned the quality of jobs created by small business which they considered to be of essence when examining the issue of job creation. In contrast, Audretsch (2002) found that small businesses are important sources of innovation and employment growth.

Similarly, Asquith and Weston (1994) concluded that industry growth patterns continue to favor small business as a significant source of job creation. These authors emphasize those small businesses that often require investment in high-tech equipment such as those providing data processing services and medical services. In addition, as further evidence that small businesses are an important force in national job creation, Dunkelberg et. al. (2004) found that, when predicting national unemployment, 80% of the variation in the unemployment rate is explained by the data collected from a survey of small business owners. Thus, the issue of relative contribution of small versus large businesses is far from settled. The current study pursues the issue for the economies of the Midwestern states. The next section discusses the data and the analysis.

III. Data and Analysis

The panel data collected for this study includes five years of data, from 1996 through 2000 for each of the eight states that make up the region of the Midwest in the United States. The data for change in employment (the difference between jobs created and jobs lost), were taken from the Census Bureau, 1989-2001 Business Information Tracking Series.
Table 1. Change in Employment Due to Small and Large Businesses 1996 - 2000

Midwestern States

<table>
<thead>
<tr>
<th>State</th>
<th>Small Business</th>
<th>Large Business</th>
<th>Ratio Small/Large</th>
<th>Average UR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illinois</td>
<td>397,226</td>
<td>138,303</td>
<td>2.88</td>
<td>4.8</td>
</tr>
<tr>
<td>Indiana</td>
<td>336,312</td>
<td>335,231</td>
<td>1.00</td>
<td>3.4</td>
</tr>
<tr>
<td>Iowa</td>
<td>156,193</td>
<td>335,231</td>
<td>0.47</td>
<td>3.0</td>
</tr>
<tr>
<td>Michigan</td>
<td>603,512</td>
<td>1,175,557</td>
<td>0.51</td>
<td>5.4</td>
</tr>
<tr>
<td>Minnesota</td>
<td>331,627</td>
<td>835,634</td>
<td>0.40</td>
<td>8.1</td>
</tr>
<tr>
<td>Missouri</td>
<td>352,802</td>
<td>954,653</td>
<td>0.37</td>
<td>4.1</td>
</tr>
<tr>
<td>Ohio</td>
<td>650,363</td>
<td>1,337,693</td>
<td>0.49</td>
<td>6.4</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>267,246</td>
<td>954,291</td>
<td>0.28</td>
<td>5.4</td>
</tr>
<tr>
<td>Midwest</td>
<td>3,474,246</td>
<td>10,498,878</td>
<td>0.33</td>
<td>3.4</td>
</tr>
</tbody>
</table>

Note: Small Business is defined as those with fewer than 500 employees. Large Business are those with 500 and more employees.

Source: Census Bureau, 1989 - 2001 Business Information Tracking Series.

Table 1 indicates the net contribution of small and large businesses to the employment of each state in the Midwest from 1996 through 2000. The data presented in Table 1 suggest that in each state, small businesses contribute more to the net employment than is contributed by large businesses. The magnitude of this difference, however, differs from one state to another. Over this period, the ratio of job creation by small versus large businesses ranged between a low of nearly two to one for Iowa, to a high of over nine to one for Ohio.

Given that the period examined was marked by acceleration in the downsizing and outsourcing of jobs, there is a possibility that large businesses were simply a larger source of job destruction. Therefore, the possibility remains that large businesses created the majority of jobs. However, the data indicating change in employment favor small businesses. In other words, the net effect shows that small businesses were a greater source of job creation, perhaps because fewer jobs were eliminated by these businesses. The data for employment due to birth of a business, employment due to expansion of a business (both large and small businesses), as well as employment generated by small businesses of various sizes were collected from the Census Bureau, 1989 &c 2001 Business Information Tracking Series.

Table 2. Creation of Employment by Small and Large Businesses by Source 1996 - 2000

Midwestern States

<table>
<thead>
<tr>
<th>Business Type</th>
<th>Small Business</th>
<th>Large Business</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Due to Birth</td>
<td>Due to Expansion</td>
</tr>
<tr>
<td></td>
<td>Due to Birth</td>
<td>Due to Expansion</td>
</tr>
<tr>
<td>Illinois</td>
<td>747,218</td>
<td>1,635,054</td>
</tr>
<tr>
<td>Indiana</td>
<td>358,212</td>
<td>723,722</td>
</tr>
<tr>
<td>Iowa</td>
<td>156,193</td>
<td>335,231</td>
</tr>
<tr>
<td>Michigan</td>
<td>603,512</td>
<td>1,175,557</td>
</tr>
<tr>
<td>Minnesota</td>
<td>331,627</td>
<td>835,634</td>
</tr>
<tr>
<td>Missouri</td>
<td>352,802</td>
<td>954,653</td>
</tr>
<tr>
<td>Ohio</td>
<td>650,363</td>
<td>1,337,693</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>267,246</td>
<td>954,291</td>
</tr>
<tr>
<td>Midwest</td>
<td>3,474,246</td>
<td>10,498,878</td>
</tr>
</tbody>
</table>

Note: Small Business is defined as those with fewer than 500 employees. Large Business are those with 500 and more employees.

Source: Census Bureau, 1989 - 2001 Business Information Tracking Series.

Table 2 presents the data regarding creation of employment by both small and large businesses. It shows employment that was created through birth as well as those created through expansion of a business. The evidence in Table 2 suggests that in every Midwestern state, the total number of jobs created by small businesses exceeded those created by large businesses. Moreover, Table 2 shows that not only this conclusion is true about the aggregate figure, but the creation of employment is higher for small businesses in both categories of birth and expansion. Therefore, one can conclude that for the Midwest, over the study period, small businesses have been a more forceful engine for employment creation. Small business, however, is defined as any business with fewer than 500 employees. It is not clear from Table 2 whether there are sub-divisions within the small business category which contribute more to the overall employment picture. Table 3 below presents the data that differentiate small business by their number of employees.
Table 3 shows changes in employment by the size of the enterprise for every state. The data in Table 3 seem to confirm the notion that small businesses are the most effective vehicle for job creation. The Table shows that the largest percentage of jobs created in the small business category is due to the smallest of them all, those with four or less employees. There was also substantial job creation, with few exceptions, for the next smallest 5 to 9 employee enterprises and then 20 to 99 employee businesses. Again, the data supports the conclusion that small businesses have been, during the 1996-2000 period, a reliable source of employment creation.

To examine the determinants of employment creation by small and large businesses, a linear relation between total employment by each type of business and several macroeconomic variables was assumed. The explanatory variables were unemployment rate (UR), percent of population with high school or higher degrees (EDUC), corporate tax rate (Corp-T-rate), and income per capita (Inc/Cap). The variable unemployment rate was postulated to be positively related to employment generated by new businesses because when the unemployment rate is higher, individuals are more inclined to start their own businesses. In addition, business expansion through hiring additional employees is easier when the unemployment rate is higher than when the labor market is tight. It was hypothesized that the higher levels of education in a given state will help the formation of businesses and thus, employment creation. Similarly, the variable income per capita (Inc/Cap) is expected to have a positive relation with employment creation as higher levels of this variable are indicative of a healthier economic atmosphere. The variable corporate tax rate, on the other hand, has an inverse relation with business profits and thus, will be negatively related to employment generated by businesses due to starting new businesses or expanding the old ones. The data for unemployment rate (UR) came from The U.S. Bureau of Labor Statistics, geographic Profile of Employment and Unemployment, annual issues 1996 – 2000. The data for the education variable (EDUC) reflects the educational attainment of population of 25 years or older who have earned a high school degree or more, in percent. The source of the 1996 education data was The U.S. Census Bureau & Educational Attainment: Historical Reports, Detailed Tables. The education data for the 1997 through 2000 were obtained from Statistical Abstract of the United States 1998 through 2001. The sources of data for income per capita (Inc/Cap) and corporate tax rates (Corp-T-rate) were the Bureau of Economic Analysis and Tax Foundation Web sites, respectively.

### Table 3. Change in Employment by Size of the Enterprise 1996 - 2000

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>1 - 4</th>
<th>5 - 9</th>
<th>10 - 19</th>
<th>20 - 99</th>
<th>100 - 499</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Illinois</td>
<td>179,958</td>
<td>49,023</td>
<td>29,899</td>
<td>80,562</td>
<td>57,794</td>
<td>397,226</td>
</tr>
<tr>
<td>Indiana</td>
<td>80,170</td>
<td>20,414</td>
<td>9,297</td>
<td>8,118</td>
<td>19,822</td>
<td>138,303</td>
</tr>
<tr>
<td>Iowa</td>
<td>37,054</td>
<td>5,625</td>
<td>68,21</td>
<td>7,281</td>
<td>8,786</td>
<td>58,258</td>
</tr>
<tr>
<td>Michigan</td>
<td>146,312</td>
<td>38,251</td>
<td>7,757</td>
<td>26,451</td>
<td>1,460</td>
<td>222,211</td>
</tr>
<tr>
<td>Minnesota</td>
<td>91,221</td>
<td>27,987</td>
<td>21,641</td>
<td>36,174</td>
<td>18,576</td>
<td>195,779</td>
</tr>
<tr>
<td>Missouri</td>
<td>79,176</td>
<td>16,411</td>
<td>10,533</td>
<td>26,338</td>
<td>6,030</td>
<td>139,160</td>
</tr>
<tr>
<td>Ohio</td>
<td>147,298</td>
<td>41,557</td>
<td>23,674</td>
<td>35,024</td>
<td>21,781</td>
<td>269,334</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>81,601</td>
<td>19,416</td>
<td>11,121</td>
<td>20,332</td>
<td>21,307</td>
<td>153,867</td>
</tr>
<tr>
<td>% of Total</td>
<td>45</td>
<td>12</td>
<td>8</td>
<td>20</td>
<td>15</td>
<td>100</td>
</tr>
<tr>
<td>% of Total</td>
<td>55</td>
<td>19</td>
<td>7</td>
<td>12</td>
<td>15</td>
<td>100</td>
</tr>
<tr>
<td>% of Total</td>
<td>64</td>
<td>10</td>
<td>6</td>
<td>12</td>
<td>15</td>
<td>100</td>
</tr>
<tr>
<td>% of Total</td>
<td>68</td>
<td>11</td>
<td>5</td>
<td>13</td>
<td>14</td>
<td>100</td>
</tr>
<tr>
<td>% of Total</td>
<td>66</td>
<td>10</td>
<td>6</td>
<td>12</td>
<td>15</td>
<td>100</td>
</tr>
<tr>
<td>% of Total</td>
<td>67</td>
<td>11</td>
<td>5</td>
<td>13</td>
<td>14</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Census Bureau, 1999 - 2001 Business Information Tracking Series.
Table 4 shows that both regression models are highly significant as evidenced by the overall measures of goodness-of-fit. All estimated coefficients in both models have the postulated signs. In the model estimating employment creation by small business, all estimated parameters are significant at better than 1% significance level except for the coefficient of EDUC which is significant at the 10% level. The variable education is not significant in the equation for large business. A strong statistical significance was not found for EDUC because this variable did not contain much variation. This is because the percentage of educated people in a state does not vary much from one year to the next. It is hard to accept the fact that the educational attainment of the most likely employees would not be a significant factor affecting a company’s decision to choose a location as its home. However, one may conjecture that a company which employs over 500 people is perhaps a “global” company that is able to draw on resources, including human resources, across state lines. Therefore, formation or even expansion of such companies may not depend significantly on the “educated” people in a given state. The opposite is true about small businesses that are more likely to tap into the human capital available in their home base.

IV. Conclusions

Examination of data regarding employment creation of small and large businesses suggested that for every state in the Midwest, small businesses, defined as those enterprises with fewer than 500 employees, have been the dominant force in the area of job creation. The findings also show that among small businesses, the smallest of them all, those with one to four employees, created the majority of the jobs. Therefore, for policy makers in the Midwest, support of small businesses, their formation and their expansion, must be a priority in any plan that aims to promote employment. For example, as was discussed in a small business forum in Fort Wayne, Indiana (Stockman, 2005), creating a climate where small businesses can thrive and grow sometimes can be as simple as improving access to these businesses through improvement of roads and provision of parking spaces.

Because educational attainment of population was found to be a significant explanatory variable for job creation by small business, results of the study suggest that the public policy of enhancing support of educational institutions in each of Midwestern states is consistent with a “pro-business” policy. In addition, the findings of the study suggest that higher tax rates have an inverse relation with job creation by both small and large businesses. Given that small businesses are the stronger engine for employment creation in the Midwest, if tax abatement or tax cuts are considered as part of an economic development strategy, the results of the paper suggest that small business must be given a priority for these preferential fiscal policies.

These results, however, analyze only the quantity of jobs created. To promote prosperity and to achieve improvement in the standard of living of the working people, quality of jobs need to be taken into consideration as well. In addition, the results obtained in this study are based upon the analysis of data from 1996 through 2000. This was a period of growth and prosperity in the United States where the economy was enjoying one of its longer expansionary periods. Before final conclusions can be drawn about the relative role of small business in the economic life of the Midwest, one may need to examine data when the economy was experiencing contraction as well as when going through expansion. The recent past, 2001 through 2004 is an ideal period to be studied. However, the detailed data about business employment creation will become available with several years of lag. In addition, future research on determinants of job creation and sources of those jobs focusing on other regions in the United States could shed additional light on the topic.

V. References


https://web.archive.org/web/20100627210028/https://secure.cbu.edu/mt/abr/archives/200...


March 24, 2006

Targeting the Asian-Indian American Market

Most U.S. marketers are woefully ignorant about most foreign cultures and do not understand that to be successful, it is important to build a positive relationship with ethnic niche markets. This paper discusses the market potential of the Asian-Indian American market by highlighting the demographic characteristics and the changing population density of this ethnic market.

by: Jacob M. Chacko, Clayton State University
jacobmchacko@mail.clayton.edu

INTRODUCTION

Present day marketers face many challenges. Challenges such as increasing competition, a majority market that is decreasing in size, the emergence of many minority niche markets that are demanding that marketers cater to them on their own terms, increased sophistication of consumers, decreased effectiveness of marketing tactics, emergence of new marketing tools, and advancements in technology and communications. Few marketers understand the fact that by the year 2050 there will be no racial majority in the United States (RAND 2001). Outdated is the notion that the United States is a melting pot where many races mix together since the nation now appears to have many distinct ingredients that never quite blend.

While some large companies such as AT&T, American Express, VISA, Citibank and VISA are doing a better job of catering to minority customers, many minority consumers are still frustrated by the lack of products that are available to meet their needs. In addition, many of these consumers are turned off by the mainstream images that are still used to promote the majority of products and services currently offered in the United States. It would be a great mistake to assume that a company could employ the same marketing approach to all minority groups.

One minority niche that exists within the American marketplace is the Asian-American market that includes the following six subgroups: Asian-Indian Americans, Chinese-Americans, Filipino-Americans, Japanese-Americans, Korean-Americans, and Vietnamese-Americans. The Asian-American market values and rewards companies that build a relationship by understanding and catering to their specific needs.

This paper covers the third largest Asian-American group residing within the United States today, the Asian-Indian Americans, whose beliefs, demographics and other characteristics that are relevant to the consumption process will be described. In addition, the paper emphasizes the importance of relationship marketing when targeting this burgeoning niche market. Responding to the dramatic demographic changes underway in developed countries involves an understanding of the demographic trends as well as an understanding of the growing diversity within the population. The information provided in this study is offered to alert the reader of the market potential that is available within this group and how to reach it, but is by no means all-inclusive.
Asian Indians first immigrated to the United States in the early 1900s. This first group of Asian-Indian immigrants was either students who came to study in America or Sikhs, members of a religion that originated as an attempt to compromise between the differences of Hinduism and Islam, who came to the United States to escape intra-Indian discrimination. Most of these early immigrants were farmers or otherwise self-employed (Rossman 1994). Before the Immigration Act was passed in 1965, there were only about 25,000 Asian-Indians in America. However, in the years subsequent to 1965, Asian-Indian immigration has flourished. Based on the 2000 Census the Asian-Indian American population is now the third largest Asian-American subgroup. In spite of their recent and sizable population boom, Asian-Indian Americans continue to be all but invisible to mainstream Americans. There are two discernible reasons for the invisibility of Asian-Indian Americans.

First, they do not have the conventional attributes of an alien population but, rather, are ethnically and culturally related to the majority in this country. Because India was a British colony for many years, many of them have learned the English language and have adopted some western attitudes and behaviors.

Second, Asian-Indian Americans are Asian, but they are not Oriental. They are a product of many invasions over several centuries. India is a country with many different ethnic and religious groups. The main ethnic groups are blends of Caucasoid, Mongoloid, Austrasoid, and Negroid. India is composed of 72 percent Indo-Aryans (Aryans are people who settled in Iran and northern India), 25 percent Dravidians (the original inhabitants of India) and 3 percent Mongoloid (made up from Mongolia, Korean, Japanese, Turks and Chinese) and other (CIA 2003).

The religious composition of the Indian people include 81.3 percent Hindu, 12 percent Muslim, 2.3 percent Christian, 1.9 percent Sikh, and 2.5 percent from other groups including Buddhist, Jain, and Parsi. The religious makeup of Asian-Indian Americans somewhat mirrors the composition in India.

Many languages are used in India and these include English, which enjoys associate status but is the most important language for national, political, and commercial communication, Hindi, which is the national language and primary tongue of 30 percent of the people, and 14 other official languages.

India is multicultural with various practices relating to food, clothing, the use of symbolic forms, and rituals that have regional as well as sub-cultural variations, while they also have many common threads at the religious, social and semantic levels (Venkatesh 1994). The Indian society is stratified hierarchically and laterally on the basis of caste, which is a social category that is unique to India, which has some resemblance to race and class-based stratification (Venkatesh 1994).

Asian-Indian Americans can be into three distinct segments. The first is the highly educated group that immigrated to the United States in the 1960s for professional opportunities. The second segment was also highly educated and came to the U.S. in 1970s. The difference between the first and second segment is that, in the second segment both husband and wife were educated and worked outside of the house. The third segment of Asian-Indians is immigrants who were sponsored by an established family member in the U.S. This group is not very educated and is mostly small business owners (Mogelonsky 1995).

Helweg (1987) finds that individualistic models of emigration decisions do not apply to Asian Indian emigrants; their concern is more with bringing honor to their extended families. Getting a prestigious foreign education in England or America is one way to do this, and this is most commonly the purpose for which Indians initially come to the United States. Even with good intentions to go back, after obtaining a graduate education many Indians decide to stay and work in the United States, often arguing that this will allow them to accumulate money and better prepare them to get a good job in India. After they experience America as students, material desires often dominate desires to return to family, friends and India. Both because of considerably poorer job and income prospects in India and because of the potential for bringing their families shame by appearing to return to India as failures, most of those who begin working in the United States continue to do so (Mehta and Belk 1991). However, with the explosive economic growth that India is experiencing, an increasing number of Indian students and naturalized citizens are opting to return to India to look for professional career opportunities.

Asian-Indian Americans have not developed the cultural and political organizations and ethnic neighborhoods that are typical of most Asian-American groups. This is because their high levels of education and professional opportunities coupled with the vast cultural diversity of their native country have either made it unnecessary or difficult for them to do so (FIND/SVP 1995).

DEMOGRAPHICS

The Asian-Indian American population has increased tremendously over the last two decades. In the ten years between 1980 and 1990, their population increased from 387,223 to 815,447, an increase of 110.6 percent. This increase was the third largest population increase among Asian-American minorities, making Asian-Indian Americans the fourth largest Asian-American group. Between 1990 and 2000 their numbers grew to 1,678,765, which is an additional increase of 106 percent. Asian-Indian Americans are now the third largest Asian demographic (FIND/SVP 1995 and U.S. Census Bureau 2000).

Like other Asian Americans, Asian-Indian Americans reside mainly in urban communities, but their population distribution more closely resembles that of the entire United States population. According to the 1990 Census, approximately 50 percent of the Asian-Indian American population was distributed among the country’s four largest cities and surrounding areas—New York, Los Angeles, San Francisco, and Chicago (FIND/SVP 1995). With regard to the clustering of Asian-Indian Americans in metropolitan statistical areas, 95 percent or 815,447 were reported to be inside MSAs and 5 percent were outside MSAs in 1990 (FIND/SVP 1995).

Of the 1.68 million Asian Indians living in the U.S., more than 1 million of them were born in India (FIND/SVP 1995). This would indicate strong ties to the culture of their birth. The median age for the foreign born population decreased slightly from 29.6 in 1980 to 29.4 in 1990. This figure compares to a median age of 31.2 in 1980 and 34.8 in 1990 for the Asian-Indian American population as a whole, which reflects an increase. By comparison, America’s Caucasian population had a median age of 31.3 in 1980 and 32.4 in 1990 (FIND/SVP 1995).

Asian-Indian Americans are a highly educated group. In 1990, 54 percent of Asian-Indian Americans had completed a bachelors’ degree or higher. By 2000, 65.8 percent of U.S. born and 68.1 percent of foreign-born Asian-Indian Americans had 4 or more years of college. This rate of educational attainment is higher than that of any other ethnic group residing in the United States.
States today. By comparison, Caucasians had a low rate of educational attainment for the same time period, only 23 percent of Caucasians had completed four or more years of college in 1990, although this number has increased to over 30 percent in 2000 (FIND/SVP 1995 and U.S. Census Bureau 2000).

Asian-Indian Americans are very well represented in professional vocations. In 1990, 77 percent of Asian-Indian Americans held a professional position, 44 percent were in the managerial/professional category and 33 percent were in the technical/sales/administrative category. The numbers, in 1990, for the Caucasian population were lower in both of the job classification categories, 33.3 percent for the managerial/professional category and 30 percent for the technical/sales/administrative category. Asian-Indian Americans included 1 percent in farm, 5 percent in craft and 9 percent in laborer occupational categories (FIND/SVP 1995).

In 1989, Asian-Indian Americans had the highest median household income of any Asian-American group at $44,696. The comparable figures for Caucasians and Asian Americans as a whole were $30,406 and $36,101 respectively (FIND/SVP 1995). In 1999, the median household income for Asian-Indian Americans increased to a high of $68,100. Again, the educational attainment, the propensity of Asian-Indian Americans to live in urban areas, and the number of wage earners per household are factors contributing to the higher median household income for this ethnic minority (U.S. Census Bureau 2000).

PSYCHOGRAPHICS

Psychographic aspects include importance of family, respect and value of age, religious beliefs, food and beverage consumption, and beliefs in simplicity and fatalism. The well being of the family is very important to Asian-Indian Americans (Rossman 1994). In addition, like most other Asian Americans, the family unit is considered to be more important than the individual. Asian-Indian Americans have large families and many extended families either live together or live within the same vicinity.

As is the case in most of the other Asian-American societies, age is highly valued within the Asian-Indian American culture. As such, elders are respected and revered. Also, the younger members of the family usually care for the elders within the family unit. Asian-Indian Americans have diverse religious beliefs. For the most part, Hinduism and Islam are the prevailing religions along with Sikh, which is a blend of the first two. However, there are several other smaller religions, such as Christian, Buddhist, Jain, and Parsi that are practiced by Asian-Indian Americans, and each religion has different beliefs.

Since Hinduism and Islam are the two main prevailing religions, marketers interested in this group of Asian Americans should be aware of their food laws. For instance, Hindus consider the cow to be a holy animal and, for that reason, do not eat beef. Muslims, on the other hand, partake of beef but refuse to eat pork. Furthermore, Muslims do not drink alcoholic beverages. It is also worth noting that many Asian-Indian Americans are vegetarians. Among Asian Americans there will be variation in food and beverage consumption based on their acculturation to the western culture.

Two additional beliefs that are worth mentioning are simplicity and fatalism. Many Asian-Indian Americans believe in simplicity. As such, they are more than satisfied with simple, sensible comforts. In addition, many Asian-Indian Americans also believe in fatalism, a belief that whatever happens in life was meant to be and cannot be changed.

MARKETING TO ASIAN-INDIAN AMERICAN

In order to successfully market to the Asian-Indian American minority, marketers must not only know where they reside, but they must also know how to reach them. A careful study of the previous psychographic reveals four basic values that are of particular relevance to this group. They are education, family, respect for age, and the importance of traditional values.

To reiterate the information previously offered, Asian-Indian Americans consider education to be of extreme importance. For the most part, they consider the education attained by an individual family member to bring honor to the entire family. The higher the level of education attained, the greater is the honor that is brought to the family. When appropriate, enterprising marketers may use this theme to market a product or service.

Asian-Indian Americans are known to be hard workers and strongly committed to their vision and goals. They are often fully committed to their responsibilities with very low default rate on business loans. They are quality conscious and very loyal to strong brands and will pay the price. However, they are also highly price/value conscious because they have had to work hard for money and will not spend it indiscriminately.

Asian-Indian Americans consider the family unit to be of extreme importance, and most have great respect for the elders of the family. In addition, they consider traditional values to be particularly important to the continuation of their respective cultures. Marketers may use these values to the advantage of a specific promotional campaign. For example, a marketer might consider using a family theme, where applicable, to promote a particular product or service, such as an automobile, or fire insurance. Additionally, an advertiser may equate the respect for the elders in a family to respect for age and apply that respect to an advertising campaign by stressing the tried and proven performance of a specific product or service.

Finally, an advertiser may want to make the most of the need Asian-Indian Americans have to preserve their respective cultures when recognition of that need may help to sell a particular product or service. Marketers who get involved in Asian-Indian American community groups and civic and trade associations through sponsorships can build relationships and gain the trust and loyalty of this group. These types of involvement generate word-of-mouth referrals that are extremely effective due to the group’s commitment to family and culture

Language and media are important considerations when planning an advertising campaign for any minority. Since Asian-Indian Americans speak English more regularly than they do any of the Indian languages, marketers should use English-language ads with Indian cultural cues woven in seamlessly. However, because they tend to utilize the extensive network of Asian-Indian American print media, marketers may find it rather difficult to reach this group through mainstream media. Therefore, Asian-Indian American print media could be utilized. The following is a list of popular publications targeted toward Asian-Indian Americans: India Abroad, Silicon India, India Currents, India Post, INDUA Business Journal, India Express, India West, South Asian Insider, Kerala Express, Little India, Masala, Mehfli, News India Times, and (New York) India New York.

Since Asian Americans lead in online access and Internet usage (Silverman 2000), to succeed in drawing this traffic, web sites must specialize and appeal to the specific interests of the sub-segments of this group. To effectively reach various groups,
companies should segment and then sub-segment the markets they want to hit. Hence, it is important for companies to recognize the major sub-groups that make up the Asian-American market and then customize their promotions accordingly. In 1998 Charles Schwab, the leading online discount brokerage firm launched a Chinese-language website and found that the average balance maintained by Asian investors was 10-20 percent higher than a typical client and that they trade twice as often. Due to the high cost of acquiring new customers, it will be important to recognize the difference between mass marketing and niche marketing (Silverman 2000).

CONCLUSION

Competition within the American marketplace is heating up, and the face of today’s America is changing. More and more companies seem to be competing for a piece of the ever-growing, ever-changing pie. Realizing this, many organizations have begun to look for different ways to expand their companies and increase profits. Since America’s mainstream population has begun to grow more slowly than ever before, American organizations will need to look to other growth markets as a way to increase sales and profits. Those organizations that refuse to keep pace with the changing marketplace will begin to see decreased market share and, ultimately, profits. Short of going global, one way to stay abreast of the situation is to target one or more of the emerging minority markets. One such market, the Asian-Indian American market, is very promising.

Due to current immigration and birthrates that are higher than those of the Caucasian population, Asian-Indian Americans are presently one of the fastest-growing minorities in the United States. Many forecasters believe that current immigration laws will continue to allow Asian-American numbers to increase by vast amounts well into this millennium. These population projections, together with the ever increasing Asian-American purchasing power, and current education trends make this market a very viable target which will prove to be very profitable for years to come. Therefore, American marketers need to become familiar with and analyze Asian-Indian American cultural values in order to better address the social mores of the Asian-Indian American market.

REFERENCES


U.S. Census Bureau (2000), http://factfinder.census.gov/servlet/BasicFactsServlet

Small Businesses and the Duty to Withhold Payroll Taxes: A Formula for Failure

There are a huge number of small businesses in the United States. In fact, the Small Business Administration (SBA) which categorizes businesses with fewer than 500 employees as “small” businesses, reports that there are over 22 million of them. The SBA further reports that over two-thirds of the net new jobs created in the U.S. in recent years are attributable to small businesses, resulting in small businesses now accounting for 51% of private output in America. However, the good news of dynamic growth and job creation by small businesses is tempered to a large degree by the facts concerning their failure rates. About a third of newly created U.S. small businesses fail within the first two years of their existence, according to the SBA, and the failure rate soars to over 60% by the end of the first six years from their inception.

by: James O. Parker, M.A., J.D. M.L.T.,
Professor, Christian Brothers University, Department of Accounting, Finance, and Business Law

There are a huge number of small businesses in the United States. In fact, the Small Business Administration (SBA) which categorizes businesses with fewer than 500 employees as “small” businesses, reports that there are over 22 million of them. The SBA further reports that over two-thirds of the net new jobs created in the U.S. in recent years are attributable to small businesses, resulting in small businesses now accounting for 51% of private output in America. However, the good news of dynamic growth and job creation by small businesses is tempered to a large degree by the facts concerning their failure rates. About a third of newly created U.S. small businesses fail within the first two years of their existence, according to the SBA, and the failure rate soars to over 60% by the end of the first six years from their inception.

Any meaningful effort to determine why small businesses are so prone to failure must begin with a refinement of the data provided by the SBA. By designating businesses with as many as 499 employees as "small," the SBA has lumped together dissimilar sized companies that do not have many characteristics or problems in common. Organizations that have grown to the point that they have a few hundred employees have grown past the shaky stage of inception in which their very survival was in doubt and are likely to be well on their way to outgrowing their "small" label. They are likely to be most concerned with how to go about accelerating their growth and can afford to expand their staffs to include specialists to oversee such matters as their marketing programs, legal issues, personnel policies and accounting needs. On the other hand, the truly small business cannot generally
afford the luxury of such specialists and either adds the types of tasks best performed by specialists onto the already abundant responsibilities of managers and owners, hires people to do specialized jobs who lack the skills that they need to do those jobs, or simply allows those jobs to either go undone or only partially performed.

According to the Statistical Abstract of the United States, 2006, there were 7,183,000 businesses in the U.S. that were considered to be either partnerships or corporations, of which 6,199,000 employed 20 or fewer people. It is this group of formal business organizations with no more than 20 employees that most people are likely to regard as true "small businesses." However, most of the "small businesses" recognized by the SBA consist of sole proprietors that are often no more than an individual who has developed a part-time job as a self-employed person. These "businesses" may have even evolved from a hobby, are usually merely a source of supplemental income, and are probably not even regarded as businesses by their owners in most instances. Since the proprietors often have no intention of developing a true business in the traditional sense and employ no one other than themselves, the development or demise of such an endeavor is not likely to have much impact on the economy.

It is the over six million formal business organizations with 20 or fewer employees, along with the relative handful of larger sole proprietors, that often really struggle just to survive. These small businesses, which as a group employ tens of millions of workers, have a number of problems in common, despite the fact that the nature of their businesses is very diverse. Such businesses, along with a variety of other problems, typically face serious cash flow problems, have difficulty financing growth, and are badly understaffed. These firms cannot typically afford to hire accountants, attorneys or other specialists to work for the company and may lack the funds to even engage such professionals for regular consultations. As a result, owners and employees often are left with responsibilities that they are ill suited to perform.

One of the most basic responsibilities of businesses large enough to have employees is the duty to withhold taxes from their workers' earnings and pay them to the U.S. Treasury. However, this duty has proven troublesome for no small number of businesses. The United States General Accounting Office, in a report used as a basis for testimony before Congress, stated that on September 30, 1998, there were nearly two million businesses with payroll tax delinquencies, with a cumulative total of $49 billion. This total did not include the $15 billion in penalties that had been assessed against those businesses due to their payroll tax delinquencies, nor did it include the delinquent employers' matching shares of Social Security taxes.

In a memorandum entitled, The Collection Field Function Needs to Improve Case Actions to Prevent Employers From Incurring Additional Trust Fund Tax Liabilities, which was prepared in September, 2005, for the I. R. S. Commissioner, Small Business/Self-Employed Division by Pamela J. Gardiner, Deputy Inspector General for Audit, the payroll tax trust fund delinquency was cited as $10.6 billion. Although some of this reduction in delinquency is, undoubtedly, attributable to the government having written it off as uncollectable, a substantial amount was certainly collected as a result of more intense collection efforts by the I. R. S. and, in fact, Deputy Inspector General Gardiner, in her memorandum, mentions some of those collection efforts and urges that even more stringent collection procedures be implemented.

Failure to withhold and properly pay over payroll taxes is a serious offense. It can lead to the demise of a small business and cause serious financial and legal problems for business owners and even employees. A careful review of the duty of an employer to withhold and pay over payroll taxes is a necessity for small businesses with employees.

THE DUTY TO WITHHOLD TAXES

Often, one of the most intimidating aspects of small business formation is the prospect of having to deal with payroll taxes. Business promoters may feel that they simply lack the expertise and time that it will take to calculate the income tax and Social Security taxes that Internal Revenue Code (I.R.C.) Â§ 3111(a) requires them to withhold from their employees' earnings, then fill out the necessary forms to report the withholdings, and then pay them to the U.S. Treasury. Additionally, I.R.C. Â§ 3402 requires employers to match each employee's payments for Social Security taxes. The matching employer's share of Social Security taxes can be quite burdensome at the current rate of 7.65% on the first $94,200 of earnings for 2006 and 1.45% on all over $94,200. The 6.2% differential in rates on the first $94,200 of earnings goes toward Old Age, Survivors and Disability income (OASDI) or what we commonly think of as Social Security benefits. The remaining 1.45% covers the cost of the U.S. Medicare program which provides health care payments, primarily for the elderly. The amount of earnings upon which the tax for OASDI is calculated is indexed to the average earnings nationwide under provisions of I.R.C. Â§ 3121. Therefore, it is almost certain to increase annually.

MISCLASSIFYING EMPLOYEES IN AN EFFORT TO AVOID PAYROLL TAXES

In an effort to circumvent the responsibility of withholding, reporting and paying payroll taxes, and the cost of paying a matching employer's share of Social Security taxes, some business owners decide to use independent contractors rather than employees to carry out the work of the business. If the workers are truly independent contractors, this is an acceptable alternative. However, if the workers are actually employees that the employer has chosen to erroneously label as independent contractors in order to avoid the burden of his payroll tax responsibilities, it is a formula for disaster.

Businesses trying to pass off employees as independent contractors is nothing new. The issue often arises when the employee, who was properly treated as an employee on past jobs, receives a Form 1099 from his employer indicating the amount of his earnings, but also indicating that no taxes were withheld. The employee will then be expected to file a tax return indicating that he is self-employed and pay his income tax. He will also have to pay Self-Employment Tax since his employer will not have withheld Social Security taxes and paid a matching share. The Self-Employment Tax rate of 15.3% is double the Social Security tax rate. There are some offsetting adjustments available to the self-employed but they do not reduce the effective Self-Â¬Employment Tax rate a great deal. Unless the worker had paid estimated taxes on a quarterly basis, he may now face a huge tax deficiency when he calculates his tax liability; whereas, in previous years, when he was considered an employee and received a Form W-2 indicating both earnings and taxes withheld, he may have even gotten a tax refund. The result is often a trip to the local I.R.S. office by a bewildered taxpayer, which then leads to an audit of the employer's practices regarding payroll.

THE PENALTIES FOR MISCLASSIFYING EMPLOYEES

If it is determined that an employer has misclassified his employees as independent contractors, thereby failing to properly withhold taxes from his employees' earnings and failing to pay his share of Social Security tax, the penalty can be severe. Employers who have misclassified employees as non-employees due to "reasonable cause" will be subject to the provisions of
I.R.C. § 3509, which starts by requiring them to pay their share of Social Security taxes plus interest. Penalties are then imposed in the amount of 1.5% of the income tax that should have been withheld from the employees’ wages and 20% of the Social Security taxes that should have been withheld. If it is determined that an employer failed to withhold taxes from employees’ earnings due to “willful neglect,” the penalty provisions are increased to 3% of the income tax and 40% of the Social Security taxes that should have been withheld. The substantially higher penalty for failure to withhold Social Security taxes is especially significant since substantially more Americans pay larger amounts of Social Security taxes than they do income taxes according to The Joint Economic Committee Study of the United States Congress (1997).

If it is determined that an employer’s failure to withhold taxes from his employees’ earnings as required by law was due to “intentional disregard” of the law, I.R.C. § 3403 provides that “the employer shall be liable for the payment of the tax required to be deducted and withheld.” Of course, in addition to having to fully pay the taxes himself that he should have withheld from his employees’ earnings, the employer will still have to pay his share of Social Security taxes and interest on the total tax liability. Furthermore, I.R.C. § 3509 prohibits the employer from even attempting to recover the taxes from his employees that he must pay in their behalf.

The civil penalties detailed above may be just the beginning of the retribution faced by an employer who willfully chooses not to withhold and pay over taxes from his employees’ earnings. A party “who willfully fails to collect or truthfully account for and pay over... withholding taxes that he is required by law to collect, is guilty, under I.R.C. § 7202, of a felony punishable by fines up to $10,000, imprisonment up to five years, or both, plus the costs incurred by the government to prosecute the party.

**GUIDANCE FOR PROPERLY CLASSIFYING WORKERS**

With so much at stake, it is not surprising to find business owners more than a little distressed over the prospects of inadvertently misclassifying employees as independent contractors. One alternative to this dilemma would be to simply treat every worker as an employee and withhold and pay over the required taxes. However, this approach would be a costly alternative to the extent that a business misclassified its bona fide independent contractors and, therefore, paid matching Social Security taxes that it was not actually required by law to pay, had it chosen to classify its independent contractors as such.

There is guidance available to help businesses determine whether or not workers are independent contractors. In order to assist in the interpretation of the relatively complex Internal Revenue Code, which is the actual tax law of the U.S., the U.S. Treasury Department issues Income Tax Regulations of the U.S. (Regulations). Among those Regulations is Section 31.3401(c)-1 which establishes 20 factors that are determinative of whether or not a worker is an employee or an independent contractor.

Foremost among the factors used to determine whether a worker is an employee or an independent contractor is the degree to which the person who has engaged the worker has the right to control how that worker performs the tasks that he has agreed to do. When workers are given relatively detailed instructions as to how to actually perform their assignments, this is a strong indication that they are employees; whereas, independent contractors are merely instructed as to the result that is expected of their efforts. Of the 20 factors set forth in the Treasury Regulation for determining whether a worker is an independent contractor, no less than 11 of them deal to some degree with the issue of whether or not the employing party has the right to control the worker’s performance.

The type of instructions given a worker is the first factor listed among the 20 in the Regulation. In specific, this provision is concerned with whether or not the instructions are sufficiently detailed to warrant considering the worker to be an employee. Among the remaining factors in the Regulation that will cause a worker to be considered an employee are the requirement that the worker actually perform the work himself rather than having someone of his choosing do so, the sequence or order of the work being set by the employer, the worker being integrated into the business, an ongoing business relationship between the parties, the requirement that the worker give the employer regular oral or written reports concerning his work, and the requirement that the worker perform at the employer's place of business, even though it would be possible to do some of the work at the worker's choice of places. When employers provide training for workers, it is an ideal way for the employer to dictate to the worker how to perform his job. Also, such training programs are common for employees but rare for independent contractors. For these reasons, when employers provide training programs for workers, this is a factor that weighs in on the side of classifying those workers as employees.

Another factor addressed by the Treasury Regulation concerns a worker's use of assistants. Workers who select, hire and pay their own assistants are exercising a degree of control typical of an independent contractor; whereas, workers who are provided with assistants that they neither chose nor compensate are likely to be considered to be employees.

The method of determining a worker’s compensation is another major category used in determining whether or not he is an independent contractor. Three of the 20 factors set forth in the Treasury Regulation are devoted to this issue. Employees are generally paid at regular intervals and their compensation is calculated on an hourly, weekly or monthly basis. Independent contractors are usually paid according to the amount of work they have done and payment is generally made at certain intervals as the work progresses, or perhaps not until the work is completed. If whether or not the worker is paid for his work at all is dependent on whether he is able to complete the job at a cost that is less than the compensation for which he agreed to do the work, and it is possible that he could even lose money on the job, this strongly supports the position that the worker is an independent contractor. By contrast, if the worker is reimbursed by the employer for his business-related expenses, rather than having to cover them out of his compensation, he is more likely to be considered an employee.

Apart from the question of whether or not a worker will be reimbursed for his business-related expenses, there is the issue of who is to furnish and pay for equipment, tools, supplies, vehicles and any other items that are necessary for the worker to perform. This issue is addressed by two of the 20 factors in the Regulation. One of the factors states simply that if those things that are required by a worker in order to do his job are supplied by the employer, then this is highly indicative of the worker being an employee; whereas, if they are supplied by the worker, it is a factor supporting his being classified as an independent contractor.

An additional factor devoted to this issue that is among the 20 in the Regulation is concerned with whether or not the worker must make an investment himself in items that he must have in order to do his work. Even if the employer does provide the worker with some of the things that he needs, if the worker must obtain still others at his own expense, this is indicative that the worker is an independent contractor, provided that what he must obtain is of significant importance and cost.
Unlike employees who work for only one employer, independent contractors work for numerous parties. Two of the 20 factors in the Regulation are based on this fact. One of the factors is the actual number of parties that the worker has performed services for at any given time, and an additional factor is the worker's availability to perform services for those who might be interested in retaining him.

How the relationship between the worker and the employer may be terminated is the last major consideration taken into account by Treasury Regulation § 31-3401(c)-1. Two factors are devoted to this issue. If either party may terminate the relationship at any time, without cause, and with no legal consequences as a result, this would be illustrative of the employment-at-will doctrine that applies to most employer/employee relationships and would be persuasive evidence that the worker is an employee. On the other hand, independent contractors usually enter into contracts with those who employ them. Such contracts generally describe the task which the worker must perform and set forth conditions for termination by either party prior to completion of that task. Should either party choose to end the relationship prematurely, but without proper cause for doing so, the other party would have grounds to bring suit for damages against the breaching party. The presence of such a relationship offers some proof that the worker is an independent contractor. However, since there are many employees who labor under employment contracts which forbid early termination without cause, existence of a contract is not especially strong evidence that a worker is an independent contractor.

Were a worker who is actually an employee, labeled by his employer as an independent contractor, compensated as such, and his earnings reported to the Internal Revenue Service as payment to an independent contractor, the fact would remain that the worker is an employee. Once the worker's proper status was established by an audit, the employer would then be subjected to the appropriate penalties for having misclassified his employee. However, if an employer, without objection from his worker, chooses to treat that worker, who is actually an independent contractor, as if he were an employee, by such actions as withholding taxes and paying matching Social Security Taxes, covering the worker under Worker's Compensation insurance, and payment of unemployment taxes on the worker, that worker is virtually certain to be considered an employee for federal tax purposes. Therefore, it is essential for employers to treat independent contractors appropriately if they intend to categorize them as such in meeting their responsibility regarding federal taxes.

Appropriate treatment of independent contractors should start with a written contract. The contract should be structured around the 20 factors in the Treasury Regulation such that the worker has as many of the characteristics of an independent contractor as is reasonably possible. Finally, between January 1 and January 31st, the employer should send the worker a Form 1099 MISC, since it is not only consistent with the position that the worker is an independent contractor, but is also required by law, with a $50.00 penalty per form for failure to comply.

After reviewing the Treasury Regulation provisions, if an employer is still uncertain as to whether his workers are employees or independent contractors, there is further help available. Taxpayers may request a determination from the I.R.S. as to whether or not a worker is an independent contractor. This type of request is made by filing Form SS-8 which may be obtained from an I.R.S. office. Alternatively, the form may be requested by mail by calling 1-800-829-1040 or may be obtained from the I.R.S. web page found at http://www.irs.gov. Essentially, the SS-8, which is three pages long, asks questions about the employer's business and the nature of his relationship with the worker or workers in question that are sufficient to enable the I.R.S. to apply the 20 factors set forth in the relevant Treasury Regulation. There is no charge for obtaining this determination. Once a determination is made regarding one employee, it will also apply to others who perform similar jobs under similar circumstances.

FULFILLING THE DUTY TO WITHHOLD AND PAY TAXES

Once it is established that a worker that an employer has agreed to hire is an employee rather than an independent contractor, his next step toward meeting his duty to withhold income tax and Social Security taxes, which are referred to collectively as payroll taxes, from his wages is to have the employee fill out a Form W-4. The purpose of the W-4 is to establish the worker's marital status, number of dependents and other factors which affect tax liability. Without a W-4, the employer is expected to withhold income tax from a worker's wages as if he were single and had no withholding allowances. Employers are not required to send W-4 forms to the I.R.S. except for forms indicating in excess of 10 withholding allowances. It is due to the fact that tax protestors often claim excessive withholding allowances to prevent employers from withholding taxes from their wages that has led to the requirement that W-4 forms with over 10 withholding allowances must be sent to the I.R.S. Employers must also obtain each employee's Social Security number and must verify the accuracy of the number. Verification is available by calling 1-800-772-6270. Since it is illegal to earn money from employment in the U.S. without a Social Security number, it is imperative that employers obtain and verify each employee's number in order to avoid penalties for their role in aiding their employees' violation of the law.

Once a worker's filing status and number of withholding exemptions are established, the appropriate withholding taxes can readily be calculated by consulting Publication 15, an I.R.S. booklet commonly known as Circular E, Employers Tax Guide, which includes charts showing the appropriate levels of withholding for each marital status at each level of withholding allowances, up to a total of 10. For those who feel the need for further assistance, the I.R.S. conducts classes, free of charge, for the purpose of instructing employers in fulfilling their duty to withhold and pay taxes.

Employers must pay the taxes that they have withheld from their employees' wages, along with their matching share of Social Security taxes, to the U.S. Treasury. An employer must have an Employer Identification Number (EIN) in order to establish an account into which the taxes are to be paid. The EIN is obtained by applying for it on a Form SS-4, which may be obtained at a local I.R.S. office or through the I.R.S. web site. The form is accompanied by basic instructions and even more detailed instructions are available in I.R.S. Publication 1635.

Once an EIN is issued to a business, the I.R.S. usually sends payment coupons to the employer to use in making payments of the taxes withheld. All but the smallest banks are authorized to accept payments of payroll taxes from employers in behalf of the U.S. Treasury. The best way for employers to make their payroll tax payments is to write a check for the taxes to the bank on which the check is drawn. If there are sufficient funds in the account to cover the check, the employer will be given credit for having paid the taxes when the check is given to the bank, rather than having to wait for the check to clear in order to get credit for it, as he would had he paid the taxes with a check drawn on a bank other than the one where he made the payment. Initially, small businesses must pay withholding taxes and their share of Social Security Taxes to the Treasury by the 15th day of the...
month, or the next business day when it falls on a weekend or holiday, following the month for which the taxes were withheld. If the total of those taxes is less than $1,000 per quarter, such employers may make quarterly payments. Businesses with annual payroll taxes in excess of $50,000 will eventually have to make payments semiweekly, and those whose payroll taxes exceed $200,000 annually will be required to make their payments electronically.

CONSEQUENCES OF FAILURE TO PAY WITHHOLDING TAXES

Although there is a certain degree of complexity associated with an employer's duty to withhold taxes from his employees' earnings and pay them to the Treasury, there is sufficient guidance available from the I.R.S. to permit those who do not choose to hire accountants to do the work to properly calculate and pay the taxes themselves. However, there are still a number of small businesses that fail to comply with the law concerning payroll taxes. The failure to comply is not generally due to small business operations being unable to determine their payroll tax obligation, but, rather, it is usually due to their choosing not to pay the taxes that they know they owe.

Noncompliance with the duty to withhold and pay taxes is generally a by-product of cash flow problems. In theory, employers take part of the earnings of their employees and pay them to the Treasury for taxes. In reality, employers start writing checks to cover all of their bills, including net wages after deducting payroll taxes, and oftentimes simply run out of money before they have managed to pay everything. Since employees would likely quit if they were not paid their net earnings, landlords would likely evict for nonpayment, utility and telephone companies would likely turn off services when not paid, and suppliers would no longer fill their orders when prior invoices remained unpaid, employers are likely to feel that they simply must pay these and other obligations ahead of their payroll taxes. After all, the I.R.S. is not going to take adverse action nearly as quickly as the employer's workers and suppliers, and employers often reason that this delay will give them time to earn profits and catch up on delinquent taxes.

Although the I.R.S. may respond relatively slowly to a company's failure to meet its payroll tax obligation, when the response does come, the consequences can be devastating. A payroll tax payment that is even one day late carries a 2% penalty, which is increased to 5% if the payment is six to 15 days late. The penalty is increased to 10% on payments that are 16 or more days late. The 10% penalty is also imposed on payments that are made to financial institutions that are not authorized to receive them and on payments that were required to be made electronically but were not. Once the I.R.S. detects a delinquency in payroll tax payments, it will send a notice demanding payment of the past due taxes. If the taxpayer makes payment within 10 days from the date of this first notice of delinquency from the I.R.S., the penalty imposed will be 10%. However, failure to respond to the first demand notice with payment within 10 days will result in an increase in the penalty to 15%. Should the employer become so delinquent in the payment of payroll taxes that he is considered to have willfully failed to pay over the taxes, I.R.C. § 6672 provides for the truly onerous penalty of 100% on the part of the delinquency that represents taxes withheld from his employees' earnings, known as the trust portion of the payroll taxes since the employer is deemed to be holding tax deductions in trust for the U.S. Treasury.

One of the most troublesome aspects of delinquent payroll taxes and the penalties associated with the delinquency is the fact that the I.R.S. has the right to collect much of it personally from the individual who had the duty within the company of seeing to it that the payroll taxes were collected and paid. The fact that the company was a corporation, a limited liability company, or any other type of organization offering limited liability, will not matter as far as liability for the delinquent trust portion of payroll taxes, and the penalties and interest on that delinquency, are concerned. Although the liability can extend to mere employees, in most small businesses, it is usually one or more of the owners that are held accountable. Of course, this puts the personal assets of the responsible parties at risk of seizure and sale by the I.R.S. in order to satisfy the obligation.

By the time a small business has gotten significantly behind on payroll taxes, it is not unusual for the owners to have exhausted their personal assets and have gone into debt trying to keep the business going. Personal bankruptcy by each of the owners may be inevitable and concern over personal liability for delinquent payroll taxes may be abated by the prospect of being able to discharge the obligation through the anticipated bankruptcy proceedings. It is true that personal tax liabilities that have first come due within three years of the filing of a bankruptcy petition can generally be discharged; however, 11 U.S.C. 523(a)(4) of the U.S. Bankruptcy Code specifically excludes liability for the trust portion of payroll taxes and the penalty and interest on the delinquency from dischargeability. It does not matter how long ago a party was found to be liable for the trust portion of payroll taxes plus penalties and interest, filing bankruptcy will not relieve him of his obligation.

In light of the fact that business owners may be deemed to be personally liable for the trust portion of delinquent payroll taxes along with penalties and interest, coupled with the fact that the liability cannot be discharged by filing bankruptcy, once business owners with such an obligation realize that survival of their company is seriously in question, it is imperative that they focus their plans and efforts toward eliminating or at least minimizing that obligation. To the degree that owners have taken funds out of the business within the tax year, but which were not treated as wages or salary, the funds should, to the extent possible, be returned to the company and used to pay the payroll tax deficiency. Otherwise, those funds may be a form of taxable income, generating their own tax liability, and leaving less money to cover the payroll tax deficiency. Furthermore, payment of current and delinquent payroll taxes should be given highest priority for payment, even if such obligations as wages, rent, utilities and the invoices of various suppliers must go unpaid, since owners of business entities that are characterized by limited liability will not be personally liable for those other obligations. Even in situations such that the owners of a company are personally liable for the debts of the business, they should still pay the company's payroll tax obligation ahead of their other commitments since practically all of the other debts will be dischargeable in bankruptcy.

As with creditors in general, the I.R.S. must honor any stipulations that taxpayers make regarding how to apply payments to their tax liability. Therefore, when business owners make payments toward deficiencies in payroll taxes, they should stipulate, on their check or otherwise, that the payment is for "the trust portion of payroll taxes" when they are unable to pay the deficiency in full. This is due to the fact that the non-trust portion of payroll taxes, which consists of the employer's matching share of Social Security taxes, is not subject to the same penalties as the trust portion, will not become the personal liability of owners who otherwise enjoy limited liability for company obligations, and is fully dischargeable in bankruptcy when the time requirements for discharge are met.
The civil penalties discussed above certainly provide ample incentive to avoid payroll tax deficiencies. However, I.R.C. § 7202, which provides for sanctions for willfully failing to withhold taxes from employees' wages, applies to failure to "...truthfully account for and pay over..." the taxes withheld, as well. As with willful failure to withhold taxes, the maximum penalty for a violation involving failure to properly pay over the taxes withheld is a fine of up to $10,000, imprisonment of up to five years, or both, plus the costs incurred by the government to prosecute the party.

CONCLUSION

Since the U.S. Treasury’s action to collect delinquent payroll taxes is likely to be much slower in coming than the consequences of failure to pay other creditors, business operators are often tempted to put off payment of those taxes in order to pay the more pressing claims. However, unlike other creditors, the I.R.S. has the options of imposing heavy penalties or seeking criminal prosecution, or both, as a consequence of failure to withhold and pay over payroll taxes. Furthermore, the liability for taxes that were withheld from workers' salaries but not paid to the Treasury and the penalties for that delinquency, extend beyond the business entity and are deemed to be the personal obligation of the party responsible for withholding and paying over the withholding taxes, and it is an obligation that cannot be discharged in bankruptcy. In light of these dire consequences of failure to comply with the duty to withhold and pay over payroll taxes, it is incumbent upon small business owners to become familiar with their duties regarding payroll taxes and give compliance with that duty the highest priority.

SOURCES

Internal Revenue Code Â§ 3111(a).


