Leveling the Playing Field

How to compete with national tax firms

By Charles E. McCabe
CEO, Peoples Income Tax, Inc.

National tax firms often enjoy major competitive advantages over independent tax firms. In addition to vast financial resources and economies of scale, national firms have the benefit of "best practices" that have been evolving ever since H&R Block invented the tax industry 50 years ago. Independent firms don't have comparable financial resources to match national tax firms. But, they do have the advantage of greater flexibility and the ability to innovate. Independent firms can capitalize on these strengths to compete. However, to operate on a level playing field, they must also employ best practices, which represent a great equalizer.

The value of your firm is limited to the value of the clients that can be transferred to a new owner. However, a growing tax preparation business with potential for continued growth and geographic expansion can often double that value. But a growing practice requires a few more resources, including a larger staff.

Recruiting and Training Tax Preparers

Growing a business beyond your personal capacity obviously requires additional people. The best practice used by many national tax firms is to operate a tax school. H&R Block developed a method of recruiting and training seasonal tax preparers some 40 years ago to support its continued growth. These schools recruit people-oriented students who pay a modest fee to cover the cost of books and materials. There is no obligation for students to work for the tax firm and no commitment for the firm to hire graduates. The instructor has the opportunity to observe students during the tax course and determine which ones would make good employees. This screening process helps firms avoid costly hiring mistakes because they can then hire qualified graduates who have demonstrated competency in tax preparation and who also meet their employment criteria. Adopting a similar process could provide you with a pool of qualified entry-level seasonal tax preparers who have been pre-screened and are likely to fit in with your company's culture.

Tax Office Policies & Procedures

As you add more employees, communication and management become more complex. Because of your time constraints, tax preparers and other office employees might not be able turn to you whenever they have a question about how a particular situation should be handled. Yet, if you're a typical owner, you want things to be done *your* way. This situation calls for standardized answers to scores of questions such as how should the staff:

- Answer the telephone?
- Resolve client problems?
- Price, prepare, check, process, and e-file tax returns?
- Meet IRS due diligence requirements?
- Handle payments and bank deposits?
- Report daily results?

The list goes on and on. The cornerstone of best tax business practices is the use of systematic methods of operating a tax office that have been tried, refined, and proven over many years. You should document operating methods in writing in a policies and procedures manual. This "P&P Manual" serves as an essential training tool, as well as a reference guide for tax preparers and other tax office employees.

To ensure continued growth and profitability, you need to spend more time as a manager operating the business using best practices. Making this transition can be a daunting task, but there are resources to help you. (See sidebar.)

In addition to the routine "nuts and bolts" of preparing tax returns and operating a tax office, you must consider other critical elements when developing tax service policies and procedures. Two examples are tax preparer compensation and tax preparer employment agreements.

50 Resources for Independent Tax Business Owners

Tax Business Support Resources

- National Association of Tax Professionals
  www.natptax.com
- National Alliance of Tax Business Owners
  www.natbo.net
- Peoples Income Tax, Inc.
  www.peoplestax.com
- BNA Tax Management
  www.bnatax.com

Tax Business Management Products & Services

- The Income Tax School
  www.theincometaxschool.com
- IntelliManager
  www.orrtax.com/products_im.asp
- VoiceTaxInfoline
  www.abcvoice.com
- Service2Client
  www.cpawebsiteresources.com
- National Tax Publications
  www.nattax.com/taxpractice
- Tax Firm Technology Links
  www.willyancey.com/technology.htm
- E-Filing Resource Website
  www.eftoday.com
- NetBaldwin Search Engine Marketing
  www.netbaldwin.com
- Thomson Web Builder CS™
  www.creativesolutions.thomson.com/web-builder
- ActiveNation Web Design & Development
  www.activenation.com
- FileYourTaxes.com
  www.fileyourtaxes.com

Small Business Support Organizations

- National Business Association
  www.nationalbusiness.org
- Small Business Development Center
  http://sbdcnet.utsa.edu
- S.C.O.R.E. (volunteer counselors)
  www.score.org
- Local Small Business Administration Office
  www.sba.gov
- U.S. Chamber of Commerce
  www.uschamber.com
- Local Chamber of Commerce
  http://www.business.com/directory/small_business/organizations/chambers_of_commerce/
- Better Business Bureau and BBB Online
  www.bbb.org
- State Department of Business Assistance
- State Department of Economic Development

Online Small Business Resources

- *Entrepreneur* Magazine
  www.entrepreneur.com
- *Inc.* Magazine
  www.inc.com
- *Business Journal*
  www.bizjournals.com
- Guerrilla Marketing Website
  www.gmarketing.com
- The Business Plans Resource Center
  www.Bplans.com
- Microsoft Small Business Center
  www.microsoft.com/smallbusiness/resources/articles.mspx
- Business Town (links to resources)
  www.businesstown.com
- Kauffman Center Resources
  www.entreworld.org
- Edward Lowe Foundation
  www.edwardlowe.org
- Small Business
  www.BusinessTown.com
- Small Business Benefit Association™
  www.sbba.com/
- Inpact Americas
  www.inpactam.org/links.htm
- Venture Capital Information Guide
  www.capital-connection.com
- American Marketing Association
  www.marketingpower.com
- Small Business Technology Advice
  www.smallbiztechnology.com
- U.S. Small Business Administration
  www.sbaonline.sba.gov
- U.S. Department of Labor
  www.dol.gov
- United States Patent and Trademark Office
  www.uspto.gov
- IRS e-file Market Research Data
  www.irs.gov/efile/article/0,,id=118376,00.html
- IRS Website for Businesses
  www.irs.gov/smallbiz
- IRS Tax Professional Information
  www.irs.gov/taxpros
- IRS E-File Partners for Tax Professionals
  www.irs.gov/efile/lists/0,,id=101225,00.html

Recommended Books

- *E-Myth Revisited*
  by Michael E. Gerber
- *Good to Great*
  by Jim Collins
- *Nuts*—Herb Kelleher
  by Kevin Freiberg, Jackie Freiberg, and Tom Peters
- *Guerrilla Marketing* Series
  by Jay Conrad Levinson

Tax Preparer Compensation

Performance-based compensation is the ideal because it provides an incentive to employees based on the contributions they make to the company. However, preparers who simply crank out tax returns to generate fees while failing to satisfy the client and deliver true value are not making a contribution to the success of the business. To encourage friendly, competent client service, you could pay extra compensation for generating client referrals and improving client retention rates. Consider providing incentives for completing annual continuing professional education (CPE) requirements and attaining professional credentials such as the enrolled agent status. The tax office staff, including the receptionist and clerical employees, could share in an "Office Bonus Pool" equal to a percentage of the growth in office revenue over the prior year. Also consider providing incentives for the accuracy rate of tax returns prepared.

The most significant measure of a productive tax preparer's performance is client retention. Paying extra bonuses to tax preparers whose personal client retention rates exceed 75 to 80 percent could produce dramatic results in terms of growth. The pay plan should, ideally, reward tax professionals for production, while also encouraging teamwork and a commitment to providing quality client service and delivering true value.

Tax Preparer Employment Agreements

Firms that do not bind their employees to certain restrictive contractual agreements risk losing clients to tax preparers who leave the company. However, a noncompete provision that is construed as being unreasonable will not be upheld by most courts. In fact, noncompete agreements that extend beyond the employment term may not be legal in some localities and some states, such as California. However, you should not permit your employees to compete; it's a conflict of interest. If an experienced tax preparer applies for employment and has a handful of long-term personal clients, you may have the option of "buying" the clients. Another alternative might be to exclude existing clients specifically by contract addendum from your noncompete provision. The most important contract provisions are "non-solicitation" and "confidentiality" clauses that survive beyond the term of employment. Such restrictive covenants can effectively prevent tax preparers who leave from taking clients with them. It's not necessary to reinvent the wheel. Obtain a copy of an employment agreement from one of the national tax firms or from a provider of tax practice management products to use as a guideline. In any case, engage a qualified labor law attorney who is familiar with state and local laws to ensure the employment contract is likely to be upheld by the local courts.

Employment Practices and Personnel Policies

Develop best practices to ensure legal compliance when recruiting, hiring, and paying employees. Many small businesses do not use professional employee screening, interviewing, hiring, and training processes. Some firms may not even have an employment application, job descriptions, or a personnel manual. You should adopt systems and rules to ensure that employment applicants and employees are treated legally, equitably, fairly, and objectively. Let employees know what you expect of them and what they can expect in return from you. Make written descriptions available to explain employee policies (e.g., honesty, substance abuse, sexual discrimination, absences), employee benefits (e.g., vacation, holidays, and sick pay), and certain employee rights (e.g., the *Family Medical Leave Act*, if applicable). However, your firm's personnel manual can also become a legally binding contract with employees. Therefore, clearly write out all personnel policies, omitting some if they could negatively impact the firm in certain circumstances. Again, hire a qualified local labor attorney to advise you.

Tax Office Site-Selection

Growing a tax office can necessitate a move. Your site selection is a critical decision process that can make the difference between success and failure. The target community must include enough taxpayers to provide the number of clients you need at a market share that you can reasonably attain in order to realize the required revenue for a successful office. Once you determine the market, the office location is the next crucial decision. A professional office building might be appropriate for an executive-level tax service, but, for a successful mass-market tax service, you may want to consider a retail storefront with high visibility. In this case, site selection involves many key considerations.

Drawing Area. In calculating the market size a center will serve, it's critical to determine the area from which shoppers will be drawn. Population in the drawing area is a key factor, but the number of taxpayers who file returns is what really counts. On average, about one tax return is filed for every three people. If you need to add 1,000 clients in order to operate a profitable tax office, and you can easily attain a ten-percent market share, you'll need to be in a center that will draw 10,000 taxpayers, or about 30,000 people. Rent will, of course, be commensurate with the number of shoppers each center draws. Ask your local chamber of commerce or small business development center for population and demographic profiles within a three-, five-, and ten-mile radius of most intersections.

Barriers. People will generally not cross barriers to go to a particular shopping center. A barrier could be physical or psychological. A physical barrier could be a river or a highway. A psychological barrier might be cultural or economic. Because of barriers, a shopping center may not draw all of the people who live within the drawing radius of the center. So, keep in mind that barriers will limit the drawing area and the population of shoppers that a center will attract.

Traffic. The number of cars and/or pedestrians is an indication or confirmation of the potential market served by a given shopping center. Ask your county or city government office for vehicle traffic counts for that area.

Visibility. Being in the right location won't necessarily ensure success. Service, quality, and reputation is foremost. After that, good visibility is essential. If the store is hidden from the major flow of traffic in the center, it won't realize its full potential. Also, if the visibility of the store front is not maximized with appropriate signage, the potential will be limited. Rental rates in a shopping center are directly related to the traffic and exposure to that traffic. Maximize signage, regardless of the cost, to take full advantage of that exposure.

Tax Office Lease Negotiation

Once you have identified a desirable office, lease negotiation is your next major challenge. There are many pitfalls you need to avoid when negotiating a lease. Economic considerations include rent and pass-through charges, security deposit, upfitting cost, rent abatement, cost of utilities, repairs and maintenance, signage cost, and any other expenses the tenant must pay. Occupancy considerations include permitted use, sign privileges, required hours of operation, tenant rules and regulations, and other factors. Legal considerations include the lease term, options to renew, default provisions and the ability to cure, notice required to vacate, venue, casualty provisions, personal guarantee, right to subrent, and assignment rights. There are many leasing pitfalls, but there are strategies to counter these landmines. Here are just a few examples:

Escape Clause. The mistake of entering into a long-term lease for the wrong location could result in financial disaster for you. Unless the success of a new office is certain, request an "Escape Clause." This provision allows you to cancel the lease in the event that you don't realize a predetermined level of revenue during the first tax season to economically justify long-term occupancy. Even if you must pay a two-to-three-month penalty to the landlord as a lease termination fee, it would be a small price to pay compared to being locked into years of rent payments for an unprofitable office. In any case, obtain the right to subrent with the landlord's approval, with the following condition added: "Such landlord approval shall not be unreasonably withheld or delayed."

Use of Premises. Make a list of all potential uses (not just tax preparation) in the lease agreement. Add related products and services, such as bank products, e-filing, and tax planning, and include other products and services (e.g., financial products and services, mortgage brokering, insurance, etc.) that you might provide in the future. List any potential uses by a subtenant. Ideally, the use clause would be very broad, such as "all legal uses that would not conflict with the provisions of existing leases of other tenants in the center."

Default Provisions. The lease agreement must make such provisions reasonable and feasible for you to adhere to. The landlord should not have the right to terminate the lease in the event of default without providing adequate notice (10 to 30 days) and allowing you the opportunity to cure the infraction and prevent lease termination.

Security Deposit. Landlords usually ask for at least one month's rent. Security deposits tie up money that you could use as working capital, especially if you're leasing multiple offices. Security deposits ensure that the landlord will be paid if a tenant skips out or leaves the premises in need of repairs upon termination of the lease. If you have a good reputation, a history of ethical business practices, prior references, and a stable, established business, ask the landlord to waive the security deposit. Or, ask that the deposit be refunded after a year or so of satisfactory tenancy. If the landlord won't waive the deposit, perhaps he'll agree to let you hold it in trust or put it in an interest-bearing CD. Otherwise, ask the landlord to pay interest on the money.

Casualties. For most leases, in the event of damage or destruction of the premises by fire or other casualty that causes the premises to be "untenantable," the landlord has the option of rebuilding. During the time allowed to rebuild (usually three months or more), the landlord would not collect rent from you, but payments would resume after this period. If such a casualty occurred 30-60 days prior to or during tax season, you would need another location to operate during tax season. This could result in leases for two offices. Ask the landlord to grant an option for you to cancel the lease in the event a casualty results in you not being able to occupy the premises for more than 10-30 days during the tax season.

Marketing With Limited Resources

Chances are, you can't compete with the vast marketing budgets and sophisticated mass-media advertising campaigns of national tax firms. Therefore, you must find a way to market effectively with limited resources. Someone once said, "I know half of my advertising budget is wasted; I just don't know which half." The key is to spend your limited marketing dollars effectively. Mass media advertising is not feasible for most independent tax firms; targeted advertising is the alternative. To ensure the effectiveness of advertising, test each ad campaign before fully rolling it out. A direct response ad is usually desirable so that you can measure results.

Many advertising options are available, but not all are effective. If you find one that works, great! If not, business development may generate more business than advertising. The key to being successful with small-business marketing is to use options that may not be available to large-scale firms, including direct selling and networking. Some low-budget marketing tactics include:

Group Tax Service. Consider arranging employee-discount tax service programs with major local employers (or member organizations) to generate new clients. Present the idea to an employer as an inexpensive employee benefit. Ideally, the employer will provide you with an office to meet with employees on-site by appointment. Donating some portion of the fees to the company's favorite charity could enhance your firm's image and increase participation.

Seminars. If your business caters to upper-end taxpayers, conduct seminars as an effective method to recruit new clients. Consider partnering with a financial service professional to conduct joint tax and financial planning seminars. Often the financial service professional's broker-dealer will pay the entire cost, including lunch or dinner.

Public Relations and Publicity. A good use of public relations can be the most cost-effective marketing strategy. A feature article in the major local newspaper on a tax firm could produce more business than an expensive ad campaign. Getting such an article published rarely happens overnight; it takes planning, preparation, and persistence. As a member of NATP, you have pre-written news releases at your fingertips in the Online Marketing Kit at *www.natptax.com*. If you haven't used them yet, there's no time like the present; if you have, you know how valuable this member benefit is.

Networking. Many employees at national tax firms don't take the time to capitalize on networking opportunities. Take advantage of the many options available to meet prospective clients. Attending chamber of commerce networking functions and joining a tips club like Business Networking International (BNI) can also provide the opportunity for new business development through cross-referrals. Of course, membership with NATP offers many opportunities to network with your peers. Take advantage of them.

Bartering. Trade associations are cropping up in many communities and can serve as brokers for small businesses to legally exchange goods and services. The value of services or goods provided by a member to another member is credited to a member's account and used to buy products and services from other members. Essentially, this is a monetary exchange and the trade association receives a percentage (10 to 15 percent) of all exchange purchases. The association helps to match purchasers with providers. This, in turn, benefits members by marketing its products and services to those who might not otherwise buy them. It also helps you conserve cash.

Traditional Advertising. You can also take advantage of traditional advertising methods. The key is to determine the methods that work best in your community and to devote more resources to those effective marketing strategies and tactics. Remember, no matter how effective you are at advertising, your rate of client retention greatly impacts growth. If only 65 percent of last year's clients return, you must replace 35 percent before showing any growth. The most effective way to grow is to provide true value to clients.

Client Refer-A-Friend Program. More new clients come from referrals than from any other source, including advertising. Facilitate the client referral process by providing an incentive for clients to make referrals (or simply by asking clients to make referrals). The idea is simple; give each client a few client referral forms and ask the client to refer a friend or relative. The referral form includes spaces for the client to enter his or her name and address. When the referred client brings in the card, which provides a special new-client discount, the card is turned in and the client who made the referral receives a "fee rebate" check for $10-$20.

Conclusion

As an independent firm, you can compete with national tax firms by using proven best practices and by capitalizing on your strengths. Creating value requires you to recruit, hire, and train qualified employees, and to use proven systematic methods of operation. Before making key business decisions, seek the advice of experienced operators and experts. When it comes to leveling the playing field, realize there is strength in numbers. Due to the challenges imposed by limited resources, employ guerrilla marketing tactics. Fortunately, information and resources to help independent tax businesses succeed are available from NATP and other sources. See how many you can tap. ◆

Charles E. ("Chuck") McCabe, a 38-year veteran tax industry executive, has managed hundreds of tax preparation offices. He is a national speaker, teacher, and author on small business and tax practice management. Chuck is founder and CEO of Peoples Income Tax, Inc. Peoples operates multiple tax offices in central Virginia and licenses income tax school systems and tax practice management manuals to independent tax firms nationwide. He is also founding chairman of the National Alliance of Tax Business Owners (www.natbo.net).

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