CTJ Citizens for Tax Justice

Revised September 15, 2010
Original publication April 22, 2010
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Loopholes for Wealthy Owners of "Subchapter S Corporations" Will Not Help "Small Businesses"

The National Association of Manufacturers (NAM) has recently argued that President Obama's proposal to allow the Bush income tax cuts to expire for the richest two percent will hurt small business employment because many small businesses are organized as "subchapter S corporations."

S corporations are corporations whose profits are not subject to the corporate income tax, but are instead included in the income of their owners. They are not publicly traded and can have no more than 100 owners, which is why some people (erroneously) think they are always small companies. Some members of Congress have recently argued that special tax loopholes must be created for S corporations to protect "small businesses" from the loss of the upper-income Bush tax cuts at the end of this year.

The reality is that only 2.1 percent of small business taxpayers both (a) are rich enough to lose their Bush tax cuts under President Obama's proposals, and (b) receive most of their income from an S corporation that they own. Further, S corporations are not necessarily as "small" as many people assume.

- Of all small business taxpayers in 2011, only 2.1 percent will be taxpayers who receive more than half of their income from an S corporation and have income high enough to be affected by the top two tax rates returning to their pre-Bush levels of 36 and 39.6 percent.[1]

- The average adjusted gross income (AGI) for this 2.1 percent will be $1.1 million in 2011.

- In 2006, 60.5 percent of all gross receipts of S corporations went to 85,000 companies that received more than $10 million in gross receipts that year. These S corporations (only 2.2% of all S corps) also received 51.9 percent of the total business profits for S corporations.[2]

- Conversely, only 11.7 percent of gross receipts for S corporations went to the 3.2 million such companies with less than $1 million in gross receipts. These S corporations (83% of all S corps) reported only 15 percent of the total business profits for S corporations.[3]

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[1] We define small business taxpayers as those for whom at least half of their adjusted gross income (AGI) is small business income. We define small business income to include the sum of non-passive partnership income, non-passive Subchapter S corporation income, sole-proprietorship income (schedule C) and farm income (schedule F). Losses are not counted.

[2] IRS, Statistics of Income, http://www.irs.gov/pub/irs-soi/06co04s.xls.

- Some large companies are S corporations. One example is the Tribune Company, a multimedia company that is also the country's second largest publisher of newspapers, including the Chicago Tribune, the Los Angeles Times, and several others. The Tribune Company saved $1.8 billion just by changing its status to an S corporation.[4]

- If lower rates were available for a particular form of business (like S corporations), then many businesses that take other forms could be converted into S corporations to take advantage of the lower rates. Wealthy individuals who are employees of companies might even negotiate to create their own S corporations that would “sell” the individuals’ services to their true employer, in order to benefit from the lower tax rates.

[3] IRS, Statistics of Income, http://www.irs.gov/pub/irs-soi/06co04s.xls.

[4] http://corporate.tribune.com/pressroom/?p=253