



The Flow-Through Business Sector and Tax Reform

**The economic footprint of the flow-through sector and
the potential impact of tax reform**

Prepared for the S Corporation Association

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Executive Summary

This report examines the size and prominence of the flow-through business sector in the US economy and how this sector could be affected by potential reform of the corporate income tax.

Flow-through businesses -- S corporations, partnerships, limited liability companies, and sole proprietorships -- play an important role in the U.S. economy and comprise a substantial share of economic activity. In 2008, flow-through businesses:

- Accounted for nearly 95 percent of all business entities;
- Employed 54 percent of the private sector work force; and,
- Reported 36 percent of all business receipts.

Moreover, between 2004 and 2008 individual owners of flow-through business reported 54 percent of all business net income and paid 44 percent of all federal business income taxes.

Flow-through businesses are well represented in all areas of the country. They employ more than one-half of the private sector work force in every state except for Delaware and Hawaii. In Idaho, Maine, Montana, South Dakota, Vermont and Wyoming, flow-through employment exceeds 60 percent of the private sector work force.

With the large size of this sector, it is important to consider how it fits into the overall structure of the U.S. income tax. Flow-through business income is subject to the tax rates faced by their individual owners. These are the rates that affect the decision-making and economic health of these owners and the businesses they own.

The income of C corporations is instead subject to two levels of tax (the “double tax”), first when income is earned at the corporate level, and again when the income is paid out to shareholders in the form of dividends or retained and later realized by shareholders as capital gains.

The double tax affects a number of important economic decisions. In particular, the double tax:

- Increases the cost of capital, which discourages investment and reduces capital formation and economic growth.
- Increases the cost of equity finance, which encourages greater leverage among C corporations.

The flow-through form provides an important benefit to the economy by reducing the economically harmful effects of the double tax and therefore allowing for a greater opportunity for job creation and capital investment. Moreover, the flow-through form provides businesses with flexibility that may better match their ownership structure requirements and capital needs.

Recent focus on the need to lower the corporate income tax rate has also drawn attention to how flow-through businesses might be affected by tax reform.

With substantial evidence that the U.S corporate tax rate is out-of-step internationally, corporate tax reform is an important component of an overall approach to improving the current tax

system. However, corporate tax reform that lowers the corporate tax rate and pays for this change by eliminating some or all business tax expenditures would raise the taxes paid by businesses organized using the flow-through form.

With the flow-through sector representing 54 percent of all business activity, as measured both by employment and net income, tax reform could have significant consequences for flow-through businesses, jobs in the flow-through sector and therefore the broader economy.

Based on Ernst & Young LLP estimates, pursuing corporate-only reform that eliminates some or all businesses tax expenditures would increase the income taxes paid by individual owners of flow-through businesses, on average, by 8 percent or \$27 billion annually from 2010 through 2014. Hardest hit would be flow-through businesses in agriculture and mining, followed by construction and retail trade, and then manufacturing, finance, and insurance.

The Flow-Through Business Sector and Tax Reform

I. Introduction

Flow-through businesses – S corporations, partnerships, limited liability companies, and sole proprietorships – play an important role in the U.S. economy.¹ The vast majority of businesses in the United States have chosen to organize as flow-through businesses. In 2008, flow-through businesses comprise more than 90 percent of all business entities, employ 54 percent of the private-sector work force and report 36 percent of all business receipts. Between 2004 and 2008, individual owners of flow-through businesses received 54 percent of all business net income and paid 44 percent of all federal business income taxes when these taxpayers file their individual tax returns.²

With the prominence of flow-through businesses, it is important to carefully consider how the flow-through form fits into the U.S. tax system and how any particular tax reform might affect flow-through businesses. President Obama recently called for tax reform that emphasizes the need to eliminate “special interest loopholes and to lower the corporate tax rate to restore competitiveness and encourage job creation.”³ While there is substantial evidence that the U.S. statutory corporate income tax rate is out-of-step internationally, elimination of business tax expenditures to finance a lower corporate rate can raise substantial issues for flow-through businesses. Flow-through businesses could potentially lose the benefit of widely used business tax provisions such as accelerated depreciation and others without the benefit of the lower corporate tax rate. Without corresponding reform of the individual income tax, these changes would also be in addition to the higher individual income tax rates scheduled to take effect in 2013.⁴

The Internal Revenue Code (the “Code”) provides businesses with considerable flexibility in how they organize and structure their business operations. Depending on their ownership and capital needs, businesses can choose between several different organizational forms. This distinguishes the United States in comparison to its major trading partners and provides greater flexibility to the overall economy.⁵ In addition, the flow-through form helps mitigate the economically harmful effects of the double tax on corporate profits, in which the higher cost of capital from double taxation discourages investment and thus economic growth and job creation. Moreover, double taxation of the return to saving and investment embodied in the income tax system leads to a bias in firms’ financing decisions between the use of debt and equity and distorts the allocation of capital within the economy. As tax reform progresses, it is important to understand and consider all of these issues with an eye towards bringing about the tax reform that is most conducive to increased growth and job creation throughout the entire economy.

II. Current tax treatment of flow-through businesses

Flow-through businesses are subject to a single level of tax on the income earned, whether or not it is distributed. The income and expenses of flow-through businesses are reported by an entity's owners – hence the name “flow-through” or “pass-through” entities. An individual owner's flow-through income is combined with income they may receive from other sources and subject to individual income taxes. Losses, rather than accumulating within the business entity level, are also passed through to the owner where they may, subject to various limitations, be used to offset income from other sources. Thus, it is the tax rates faced by individual owners of flow-through businesses that affect decision-making and the economic health of these businesses.

In contrast, the income of C corporations is subject to two levels of tax, first when income is earned at the corporate level, and again when the income is paid out to shareholders in the form of dividends or retained and later realized by shareholders as capital gains. These two levels of tax are often referred to as the double tax on corporate profits. C corporations can generally carry losses back for two years and carry them forward indefinitely.

The flow-through form provides multiple options of entities with various ownership and capital requirements that allow entrepreneurs the potential for limited liability with the flexibility needed to choose the entity that best fits their particular business needs. Sole proprietorships are unincorporated businesses owned by a single individual. Partnerships are unincorporated business entities owned by two or more entities or individuals, without any limit on size or type of partner.

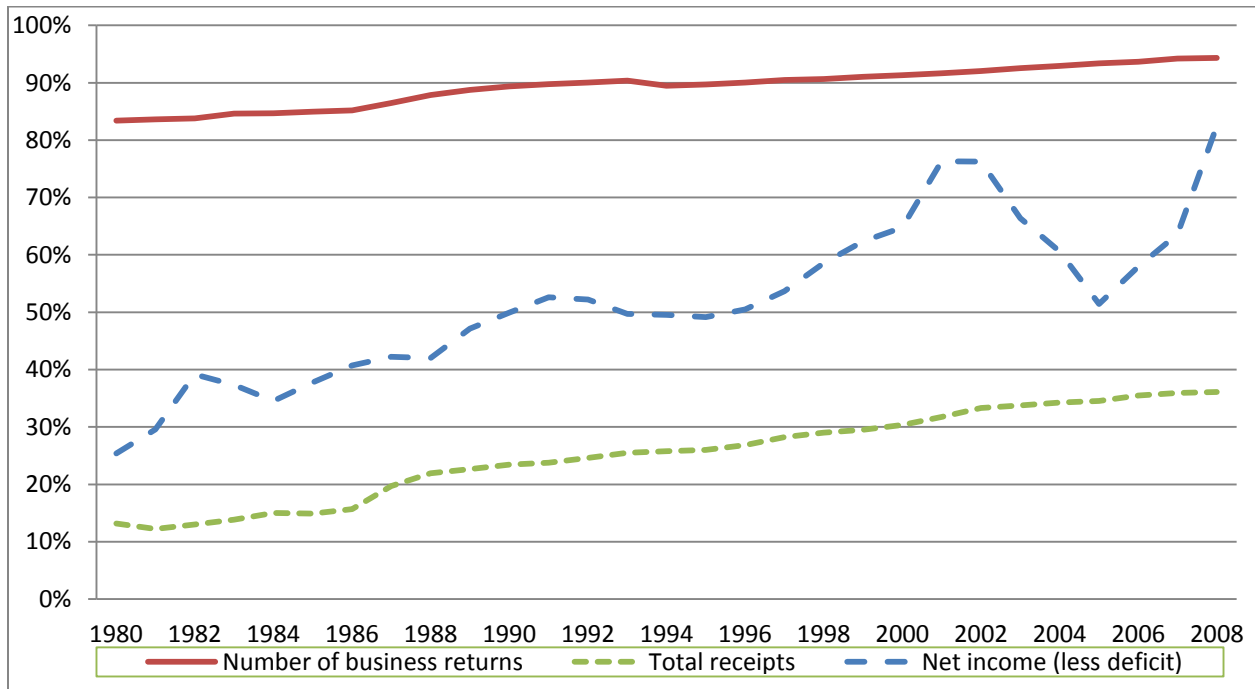
S corporations are domestic corporations that meet certain conditions that generally constrain their ability to raise capital through expansion of ownership and stock issuances. S corporations, for example, are limited to no more than 100 shareholders and one class of stock and are required to be a domestic corporation. Also, generally only individuals may be shareholders of S corporations. These restrictions can have the effect of reducing an S corporation's access to capital.

Limited liability corporations (LLCs) are flow-through business entities that combine the limited liability feature of the corporate form with the flow-through of income and losses of the partnership form.

III. Economic footprint of flow-through businesses

The economic footprint of flow-through businesses has grown steadily by several different measures. The percentage of businesses choosing the flow-through form rose from 83 percent in 1980 to 94 percent in 2008 (see Chart 1).⁶ The share of total receipts generated by flow-through businesses has nearly tripled since the early 1980s with the flow-through share of total receipts rising from 13 percent in 1980 to 36 percent by 2008. The flow-through share of net income also rose significantly, 25 percent in 1980 to 82 percent by 2008.⁷

Chart 1. Flow-through shares of all business returns, receipts, and net income, 1980-2008



Note: These data include some flow-through entities, primarily partnerships, which are owned by C corporations. Data focusing on individual owners of flow-through businesses are presented below in Chart 4.

Source: Internal Revenue Service, Statistics of Income, Integrated Business Data.

Two changes contributed to this growth.⁸ First, the individual tax rate was lowered significantly relative to the corporate tax rate under the Tax Reform Act of 1986, which had the effect of making the flow-through form more attractive for many businesses. Second, in the late 1980s and 1990s limited liability companies (LLCs) combined flow-through tax treatment with limited liability for their owners⁹ and the classification of businesses as LLCs was simplified in 1997 by allowing them to “check the box” on Form 1065-B to elect to be treated as a corporation or partnership (or sole proprietorship) for tax purposes.¹⁰

As shown in Table 1 below, the flow-through sector now comprises a large fraction of business activity not only based on number of firms and receipts/net income, but also based on the number of workers it employs. In 2008, the flow-through sector employed 54 percent of the private sector work force, with C corporations employing the remaining 46 percent.¹¹ S corporations employed 25 percent of the private sector work force, while partnerships employed 10 percent and sole proprietorships accounted for 19 percent.¹²

Table 1. Private economic activity of flow-through businesses and C corporations, 2008

	Total Private Business Sector	Flow-Through Businesses				C corporations
		Total S Corporations	Partnerships	Proprietorships	Sole	
Employment	125.6	68.2	31.0	13.1	24.1	57.4
Firms	26.9	25.1	3.6	1.7	19.8	1.7
Establishments	28.4	25.6	3.9	1.9	19.9	2.8
Receipts	28.7	10.2	5.6	3.1	1.5	18.5

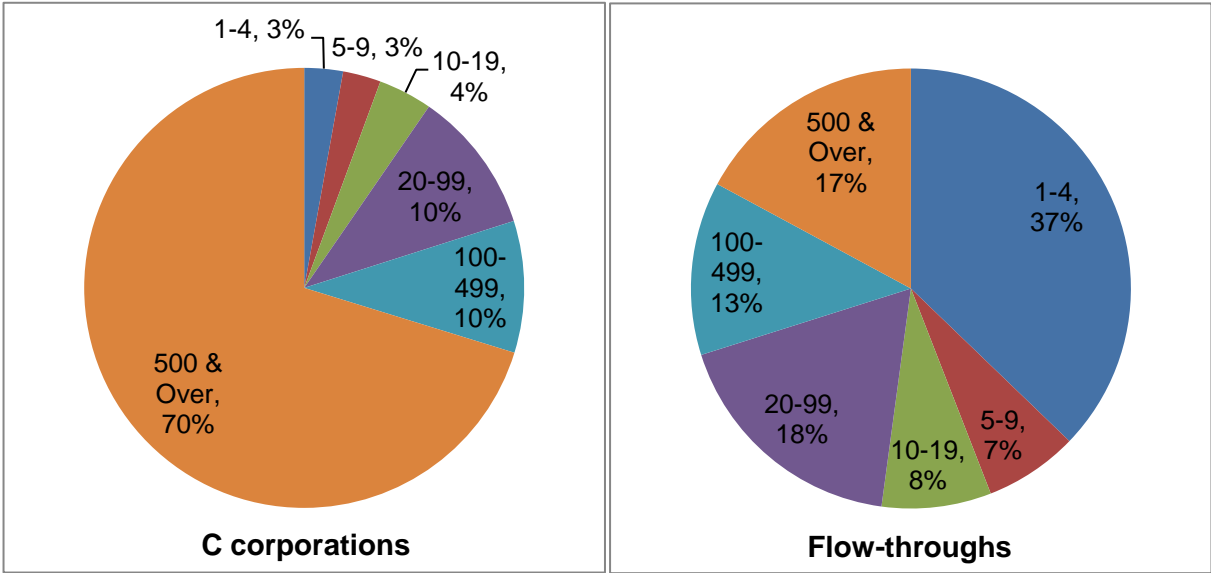
Percent Distribution

Employment	100%	54%	25%	10%	19%	46%
Firms	100%	94%	13%	6%	74%	6%
Establishments	100%	90%	14%	7%	70%	10%
Receipts	100%	36%	19%	11%	5%	65%

Note: Units in millions, dollars in billions.
 Source: U.S. Bureau of the Census, Statistics of U.S. Businesses and Non-employer Statistics; receipts are from Statistics of Income Division, selected sources.

As shown in Chart 2, private sector employment within the flow-through sector is sizable and more concentrated among smaller firms than C corporations. About 37 percent of workers within the flow-through sector were with firms with four or fewer employees. About 52 percent of workers in the flow-through sector held jobs in firms with fewer than 20 employees. In contrast, among C corporations 70 percent of workers held jobs in firms with more than 500 employees and 90 percent of workers held jobs in firms with more than 20 employees.

Chart 2. Employment by size of firm, C corporation and flow-through sectors, 2008

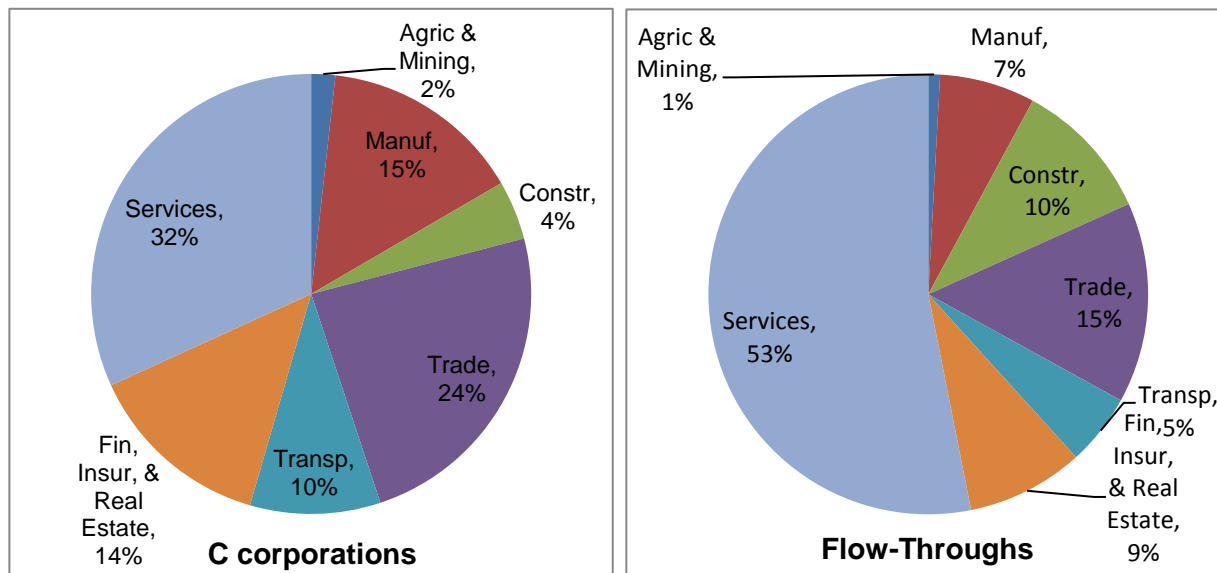


Source: U.S. Bureau of the Census, Statistics of U.S. Businesses and Non-employer Statistics.

Despite these differences in the relative size of flow-throughs versus C corporations, the number of workers employed by larger flow-throughs is significant. Approximately 20 million workers are employed by flow-throughs with more than 100 employees.

There are also considerable differences in the employment within various industries for these two sectors, with significantly greater representation of flow-through employment in the services and construction industries (see Chart 3). In contrast, C corporation employment is more dominant in the manufacturing, wholesale and retail trade, and transportation industries.

Chart 3. Employment by industry, C corporation and flow-through sectors, 2008



Source: U.S. Bureau of the Census, Statistics of U.S. Businesses and Non-employer Statistics.

It is important to point out that these employment estimates are influenced by the presence of large employers, particularly among C corporations. For example, while only 7 percent of flow-through employment is within the manufacturing sector, more than 81 percent of all manufacturers are organized as flow-through businesses.

Flow-through businesses are well represented in all areas of the country, representing more than one-half of the private sector work force in every state except for Delaware (49 percent) and Hawaii (48 percent) (state-by-state data is presented in Appendix B). Flow-through employment exceeds 60 percent of the private sector work force in six states: Idaho (65 percent), Maine (62 percent), Montana (69 percent), South Dakota (63 percent), Vermont (63 percent) and Wyoming (62 percent).

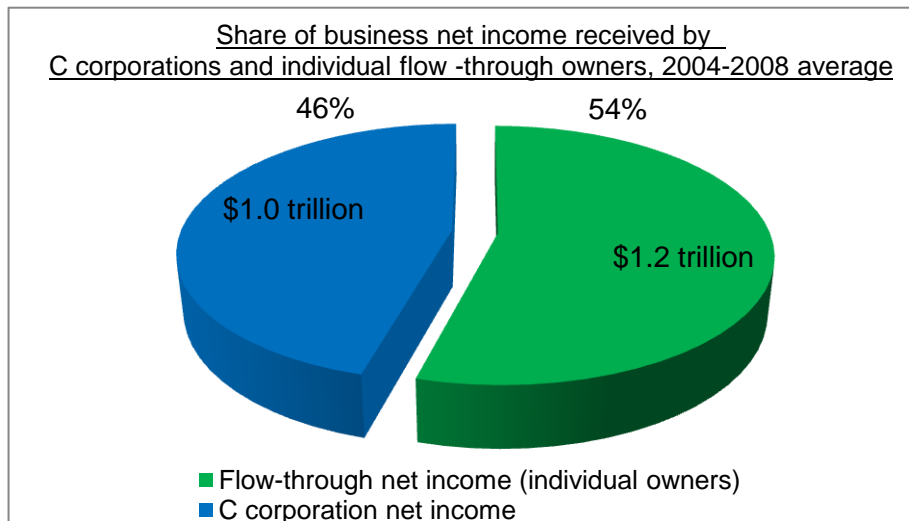
While the foregoing data provides a picture of the economic footprint of flow-through business entities, the owners of some flow-through businesses (primarily some partnerships¹³) are corporations, not individuals. This distinction is important because individual owners of flow-through businesses are taxed under the individual income tax. A significant amount of partnership income flows through to corporate owners.¹⁴ This income is often associated with various types of joint ventures between corporations.

Another important factor that makes comparisons of business entities and the flow-through income received by individual owners difficult is that a considerable share of flow-through income takes forms

other than allocated net income reported on an owner's Schedule C or Schedule E. For example, individual owners of flow-through businesses can also receive allocated income in the form of capital gains, rents and royalties. This income is reported separately from allocated net income reported on the Schedule C or Schedule E in order for it to maintain its character and receive special tax treatment under the Code (e.g., the special lower tax rate on long-term capital gains and the limitations on passive activity losses).

As shown in Chart 4, after accounting for all of the income allocated to individual owners of flow-through businesses, individual owners received 54 percent of total business income from 2004 through 2008.¹⁵ The taxes paid on this income by individual owners of flow-through businesses averaged \$232 billion annually (44 percent) from 2004 through 2008, as compared to an average of \$290 billion for C corporations over this period.¹⁶

Chart 4. Individual owners of flow-through businesses receive 54% of business net income, 2004-2008 average



Source: Internal Revenue Service, Statistics of Income, Corporate Source Book and Individual Tax Returns (publication 1304), selected years; computations by Ernst & Young LLP.

IV. Economic decisions of flow-through businesses affected by the tax system

Research has found that individual income tax rates affect various economic decisions of flow-through business owners. For example, tax rates have been found to affect the entry and exit from flow-through form as individuals decide whether to open up their own business or work for another firm.¹⁷ Tax rates have also been found to deter these businesses from hiring workers and investing and affect the rate at which flow-through businesses grow.¹⁸ The effect of the individual tax rates on these types of economic decisions is one reason the tax treatment of flow-through businesses has figured prominently in recent discussions of changes to these tax rates.

Increases in the cost of capital resulting from higher individual income tax rates was found to reduce the investment spending of entrepreneurs and the probability that they invested at all.¹⁹ A 5-percentage point increase in the individual marginal tax rate was found to reduce the percentage of entrepreneurs who made new capital investments by 10.4 percent and the mean amount of investment by 9.9 percent.

Lower individual tax rates were found to increase the probability that entrepreneurs hired workers and, for those with employees, the total amount of a firm's wages.²⁰ A 10-percent increase in the net-of-tax share (i.e., 1 minus the marginal tax rate) was found to increase the mean probability of hiring workers by 12 percent, and for those firms with employees, increase the median wage bill by 3.7 percent. Finally, a 10-percent increase in the net-of-tax share was found to increase business receipts by 8.4 percent.²¹

The concern over higher individual tax rates has, in part, been the result of the fact that the flow-through sector plays an important role in the U.S. economy and the recognition that higher tax rates on these firms' owners may result in less hiring and capital investment of businesses within the flow-through sector. These issues will arise again in 2013 due to the scheduled increase under current law in the top tax rate imposed on flow through businesses through the individual income tax income from 35 percent to 39.6 percent and the Medicare tax from 2.9 percent to 3.8 percent.

V. Tax reform and flow-through businesses

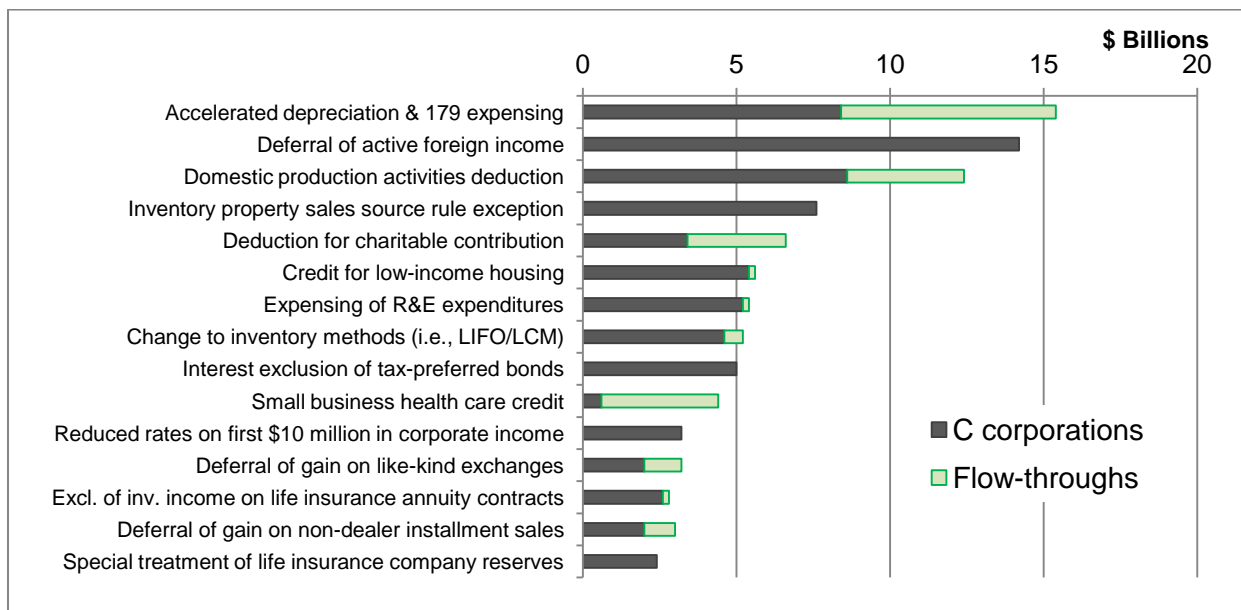
Some have suggested that tax reform focus first on reform of the corporate income tax before focusing on reform of the individual income tax. With the flow-through sector representing more than half of all business activity, as measured by employment (in 2008), and paying 44 percent of total federal business income taxes (between 2004 through 2008), tax reform could have significant consequences for flow-through businesses.

One approach to tax reform that has been suggested, for example, is lowering the corporate tax rate and paying for this change by eliminating or limiting business tax expenditures. Many of these expenditures are long-standing provisions that are available to and widely used by both C corporations and flow-through businesses.

Curtailing business tax expenditures would raise the taxes paid by owners of flow-through businesses, even though these businesses would receive no tax benefit from the lower corporate tax rate and could even face a higher tax rate if individual income tax rates increase after 2012.²² For example, if accelerated depreciation was eliminated to help finance a lower corporate tax rate, flow-through businesses would lose the benefit of this tax provision without receiving the benefit of a corresponding reduction in the corporate tax rate.

As shown in Chart 5, flow-through businesses make extensive use of a number of broadly available business tax expenditures such as accelerated depreciation, the deduction for domestic production activities, and the deduction for charitable giving. In total, flow-through businesses benefited from 23 percent of the approximately \$116 billion in annual business tax expenditures between 2010 and 2014.²³

Chart 5. Largest business tax expenditures in US, Annual average, 2010-2014*



*The value of the tax expenditure for tax-exempt bonds includes only the benefit to the corporate investors, not the benefit of lower interest rates to the issuers.

Source: Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014* (JCS-3-10), December 15, 2010, and Ernst & Young LLP calculations.

Repeal of these provisions could entail substantial tax increases for flow-through businesses that could negatively impact employment and growth in the flow-through sector. To gauge the potential impact on flow-through businesses of a “corporate only reform,” the percentage change in income tax liability associated with elimination of all business tax expenditures was calculated for flow-through businesses. The analysis takes into account all business tax expenditures permanently in effect from 2010 through 2014 and as estimated by the Joint Committee on Taxation.²⁴

The starting point for this estimate is computing the income taxes paid on flow-through income earned and allocated to individual owners of flow-through businesses. As shown in Table 2, based on simulations using the Ernst & Young LLP Individual Tax Simulation Model, individual income taxes on flow-through business income received by individual owners will average \$346 billion during 2010 through 2014 period.²⁵ About 38 percent of these taxes are paid by flow-through businesses in the finance, insurance, and real estate industry, followed by services (25 percent) and manufacturing (11 percent).

Based on Ernst & Young LLP estimates, eliminating all businesses tax expenditures would increase the income taxes paid by individual owners of flow-through businesses, on average, by 8 percent or \$27 billion annually from 2010 through 2014.²⁶ Flow-through businesses in the agriculture and mining industry would experience the largest increase in individual income taxes (22 percent) primarily due to the elimination of timber-related provisions. Flow-through businesses in the finance, insurance, and real estate industry would face an 8 percent increase in taxes due to the loss of the benefit of the tax expenditures for the deferral of gains on non-dealer installment sales, amortization of business start-up expenditures, the charitable giving deduction, as well as accelerated depreciation for certain rental property and the low income housing tax credit. In contrast, flow-through businesses in the information industry would only have a 4 percent increase in taxes, below the 8 percent average across all industries because flow-through businesses within this industry tend not to receive much benefit from business tax expenditures.

Table 2. Average annual tax increase on flow-through businesses from elimination of business tax expenditures, by industry, 2010-2014

Industry	Current Tax (\$billions)	Share of Taxes (current law)	Tax increase (\$billions)	Percent change in tax
Agriculture and mining	14	4%	3.0	22%
Utilities	2	1%	0.2	8%
Construction	26	8%	2.3	9%
Manufacturing	37	11%	3.0	8%
Wholesale trade	21	6%	1.0	5%
Retail trade	12	3%	1.1	9%
Transportation	8	2%	0.5	6%
Information	10	3%	0.4	4%
Finance, insurance, and real estate	130	38%	9.9	8%
Services	86	25%	5.6	7%
All industries	346	100%	27.0	8%

Source: Ernst & Young LLP calculations based upon multiple data sources, primarily JCT and IRS.

A corporate tax reform that lowered the corporate tax rate paid for by eliminating or limiting business tax expenditures only for C corporations would, in effect, hold flow-through businesses harmless from the reform, but would add substantial complexity to the Code. The creation of additional differences in the tax treatment of C corporations and flow-through businesses might also cause additional shifting between these business forms. Differences in tax treatment have caused shifting between the C corporation and flow-through business forms in the past,²⁷ but in this case the shift between organizational forms would result from the various tax expenditures being available only to businesses in the flow-through sector.

Another aspect of tax reform is the double tax on corporate profits created by the differential taxation of business income earned by C corporations and flow-through businesses. The double tax is economically important and can distort a number of business decisions.²⁸ One important such distortion arises because the double tax mainly affects business income generated by activities financed through equity capital within the C corporation form. Interest expenses are generally deductible by businesses, leading to a tax bias in favor of financing with debt rather than equity. The double tax thus raises the cost of equity financed investment by C corporations relative to debt financed investment and provides an incentive for leverage and borrowing rather than for equity-financed investment. Accordingly, the double tax contributes to the tax bias for higher leverage. Greater leverage can make corporations more susceptible to financial distress during times of economic weakness.

The double tax also increases the cost of investment in the corporate sector relative to the rest of the economy. This tax bias against investment in the corporate sector leads to a misallocation of capital throughout the economy whereby capital is not allocated to its best and highest use based on economic considerations. This reduces the productive capacity of the capital stock and dampens economic growth. As noted before, the diversity of organizational forms can be seen as a useful choice for businesses to make in organizing themselves, but the impact of differential treatment should be recognized. Finally, the double tax raises the overall cost of capital in the economy, which reduces capital formation and, ultimately, living standards.²⁹

VI. Summary

Flow-through businesses employed 54 percent of all private sector workers in 2008 and paid 44 percent of all federal business income taxes between 2004 and 2008. The flow-through sector provides the important benefit of reducing the scope of the double tax on corporate profits, as well as providing additional flexibility in the ownership structure of businesses providing a better match to their management needs and capital requirements.

Recent focus on the need to lower the corporate income tax rate has drawn attention to how flow-through businesses might be affected by tax reform. Corporate tax reform is an important component of an overall approach to improving the current tax system. However, corporate tax reform that lowers the corporate tax rate and pays for this change by eliminating all business tax expenditures would have the impact of raising the taxes paid by owners of businesses organized in flow-through form.

Overall, the flow-through form provides an important benefit to the economy by reducing the economically harmful effects of the double tax and therefore allowing for a greater opportunity for job creation and capital investment.

Appendices

A. Data sources/simulations

The data presented in this analysis by legal form of organization uses data from primarily two main sources: the Internal Revenue Service's Statistics of Income (SOI) division and the Census Bureau. The IRS provides tax return data for businesses that is segregated in a number of ways including by industry, size of a firm's assets, and legal form of organization (e.g., C corporation, S corporation, partnership, sole proprietorship). Because this report's main focus is an assessment of the increasing importance of flow-through businesses relative to C corporations, the primary IRS data source chosen was SOI's Integrated Business Statistics tables, which provide data from 1980-2008 on receipts, net income, and number of returns reported separately for C corporations, S corporations, partnerships and sole proprietorships. The IRS, of course, assembles these data using various tax forms filed by businesses.

This report also uses data from the Census Bureau's Statistics of US Business division (SUBS) and Nonemployer Statistics (NS), which provides business-level data (e.g., number of firms, number of establishments, employment, payroll and receipts) by legal form of organization, industry and employment size (i.e., number of employees) for the nation as a whole and select geographic types. Such data was also made available to EY on a state-by-state basis for 2007, the latest year for which the most complete data is available.

The SUBS data excludes a large number of sole proprietorship that have only one employee (i.e., only the owner). Consequently, EY combined the SUBS data with nonemployer statistics (businesses with no employees, just the owner) for 2007 to ensure proper representation of the business sector. Specifically, nonemployers were counted as one firm, one establishment and containing one employee for the purposes of the tabulations included in this report.

The simulations for calculating the percentage change in flow-through business tax liability use the EY Individual Tax Simulation Model (EY ITSM) based on a publicly available sample of roughly 160,000 individual tax returns for tax year 2004 that are then projected through 2021 using the Congressional Budget Office's economic projections. This model is used to estimate the tax liability associated with flow-through business income from 2010 through 2014 as reported on individual tax returns. Tax liability under current law is estimated as the difference between tax liability with and without flow-through business income. This approach assumes the flow-through income is earned last.

There are a few key details to keep in mind relating to the estimates cited above. First, the tax expenditure estimates that underlie the simulated effects of the reform assume no behavioral responses on the part of taxpayers. Second, the estimates assume that the tax law in effect during the period of 2010 through 2014 corresponds to the tax law in effect on December 15, 2010. This means that the estimates assume that most expiring tax provisions, including the research and experimentation credit, would expire in 2010 or remain expired (after 2009) as opposed to being extended and that the 2001 and 2003 tax cuts would expire after 2010 (in addition to no AMT relief). That is, in order to be consistent the Joint Committee on Taxation tax expenditure estimates, the above estimates do not incorporate the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 enacted in December 2010.

The estimates presented above in Table 2 also do not include the likely effect of higher state and local taxes. Because state and local income taxes largely piggyback off of the federal definition of income, flow-through businesses would not only see their federal income taxes rise, but also state and local income taxes. States and local governments could, of course, decouple from the federal change, but based on state and local governments' responses to Tax Reform Act of 1986, such responses may be unlikely.³⁰

B. State level flow-through data

The tabulations below show the number of firms, establishments, employment and gross receipts for all flow-through businesses, each flow-through organizational form (S corporations, partnerships, and sole proprietorships), and C corporations for each state and the District of Columbia. These data are based on tabulations from the Census Bureau's Statistics of U.S. Business Division and Nonemployer Statistics. The state-by-state tabulations are presented for 2007 because this is the last year in which data is available for all of the items shown.

Table B.3: Distribution of employment by legal form of organization by state, 2007

State	All business	Flow-through business		S corporations		Partnerships		Sole proprietorships		C corporations	
	Number	Number	%	Number	%	Number	%	Number	%	Number	%
Alabama	1,837,895	1,003,766	55%	463,914	25%	185,245	10%	354,607	19%	834,129	45%
Alaska	261,659	157,944	60%	59,801	23%	30,600	12%	67,543	26%	103,715	40%
Arizona	2,583,078	1,413,643	55%	633,030	25%	322,116	12%	458,497	18%	1,169,435	45%
Arkansas	1,089,793	571,969	52%	256,518	24%	103,074	9%	212,377	19%	517,824	48%
California	15,037,048	8,085,938	54%	3,333,976	22%	1,374,016	9%	3,377,946	22%	6,951,110	46%
Colorado	2,279,826	1,306,092	57%	594,802	26%	288,998	13%	422,292	19%	973,734	43%
Connecticut	1,550,971	810,849	52%	281,306	18%	222,181	14%	307,362	20%	740,122	48%
Delaware	401,517	195,805	49%	90,689	23%	50,723	13%	54,393	14%	205,712	51%
D.C.	329,243	171,877	52%	55,559	17%	68,038	21%	48,280	15%	157,366	48%
Florida	8,340,214	4,690,339	56%	2,500,106	30%	674,927	8%	1,515,306	18%	3,649,875	44%
Georgia	4,009,564	2,117,574	53%	969,182	24%	382,023	10%	766,369	19%	1,891,990	47%
Hawaii	544,028	260,558	48%	89,672	16%	58,587	11%	112,299	21%	283,470	52%
Idaho	600,526	390,987	65%	174,913	29%	86,108	14%	129,966	22%	209,539	35%
Illinois	5,563,981	3,025,478	54%	1,519,567	27%	566,608	10%	939,303	17%	2,538,503	46%
Indiana	2,675,696	1,550,751	58%	807,896	30%	313,932	12%	428,923	16%	1,124,945	42%
Iowa	1,284,305	681,452	53%	338,891	26%	100,881	8%	241,680	19%	602,853	47%
Kansas	1,186,791	621,240	52%	280,241	24%	118,821	10%	222,178	19%	565,551	48%
Kentucky	1,622,070	903,968	56%	410,695	25%	185,043	11%	308,230	19%	718,102	44%
Louisiana	1,743,826	997,002	57%	405,710	23%	246,122	14%	345,170	20%	746,824	43%
Maine	521,800	323,685	62%	150,709	29%	40,471	8%	132,505	25%	198,115	38%
Maryland	2,328,191	1,264,369	54%	583,560	25%	229,374	10%	451,435	19%	1,063,822	46%
Massachusetts	2,917,260	1,464,839	50%	708,314	24%	213,737	7%	542,788	19%	1,452,421	50%
Michigan	3,810,890	1,989,754	52%	897,541	24%	380,006	10%	712,207	19%	1,821,136	48%
Minnesota	2,456,946	1,377,604	56%	741,609	30%	181,488	7%	454,507	18%	1,079,342	44%
Mississippi	996,637	559,594	56%	216,825	22%	113,576	11%	229,193	23%	437,043	44%
Missouri	2,480,322	1,291,681	52%	595,938	24%	240,171	10%	455,572	18%	1,188,641	48%
Montana	377,986	259,814	69%	123,903	33%	39,673	10%	96,238	25%	118,172	31%
Nebraska	791,687	431,407	54%	216,194	27%	76,534	10%	138,679	18%	360,280	46%
Nevada	1,319,379	716,280	54%	312,834	24%	196,486	15%	206,960	16%	603,099	46%
New Hampshire	584,966	319,854	55%	133,298	23%	56,517	10%	130,039	22%	265,112	45%
New Jersey	3,825,850	2,074,939	54%	954,370	25%	473,173	12%	647,396	17%	1,750,911	46%
New Mexico	678,680	400,985	59%	167,125	25%	82,917	12%	150,943	22%	277,695	41%
New York	7,523,850	4,299,818	57%	1,903,324	25%	845,347	11%	1,551,147	21%	3,224,032	43%
North Carolina	3,778,299	1,990,387	53%	971,603	26%	314,065	8%	704,719	19%	1,787,912	47%
North Dakota	271,207	156,593	58%	81,008	30%	20,910	8%	54,675	20%	114,614	42%
Ohio	4,799,341	2,497,306	52%	1,167,532	24%	499,954	10%	829,820	17%	2,302,035	48%
Oklahoma	1,418,444	811,643	57%	336,322	24%	167,385	12%	307,936	22%	606,801	43%
Oregon	1,510,431	876,319	58%	404,876	27%	162,479	11%	308,964	20%	634,112	42%
Pennsylvania	4,985,333	2,764,757	55%	1,332,179	27%	485,182	10%	947,396	19%	2,220,576	45%
Rhode Island	427,484	256,161	60%	144,421	34%	34,758	8%	76,982	18%	171,323	40%
South Carolina	1,756,135	953,599	54%	452,154	26%	171,718	10%	329,727	19%	802,536	46%
South Dakota	320,323	203,248	63%	103,624	32%	27,384	9%	72,240	23%	117,075	37%
Tennessee	2,619,885	1,323,024	50%	375,202	14%	384,266	15%	563,556	22%	1,296,861	50%
Texas	10,044,248	5,300,252	53%	1,727,825	17%	1,457,088	15%	2,115,339	21%	4,743,996	47%
Utah	1,171,163	678,554	58%	339,223	29%	156,124	13%	183,207	16%	492,609	42%
Vermont	271,198	170,393	63%	75,702	28%	21,384	8%	73,307	27%	100,805	37%
Virginia	3,344,719	1,679,371	50%	822,877	25%	301,813	9%	554,681	17%	1,665,348	50%
Washington	2,581,655	1,438,399	56%	675,853	26%	269,265	10%	493,281	19%	1,143,256	44%
West Virginia	575,274	303,677	53%	113,040	20%	69,890	12%	120,747	21%	271,597	47%
Wisconsin	2,416,283	1,325,162	55%	703,287	29%	215,883	9%	405,992	17%	1,091,121	45%
Wyoming	232,779	143,929	62%	66,008	28%	28,801	12%	49,120	21%	88,850	38%
United States	126,080,676	68,592,856	54%	30,852,975	24%	13,335,862	11%	24,404,019	19%	57,487,820	46%

Source: U.S. Bureau of the Census, Statistics of U.S. Businesses and Non-employer Statistics.

Table B.2: Distribution of firms by legal form of organization by state, 2007

State	All business	Flow-through business		S corporations		Partnerships		Sole proprietorships		C corporations	
	Number	Number	%	Number	%	Number	%	Number	%	Number	%
Alabama	387,982	366,469	94%	41,438	11%	27,382	7%	297,649	77%	21,513	6%
Alaska	68,840	65,172	95%	7,048	10%	4,364	6%	53,760	78%	3,668	5%
Arizona	497,619	465,271	93%	68,110	14%	48,621	10%	348,540	70%	32,348	7%
Arkansas	244,400	230,488	94%	32,346	13%	14,854	6%	183,288	75%	13,912	6%
California	3,454,362	3,197,542	93%	314,014	9%	191,990	6%	2,691,538	78%	256,820	7%
Colorado	550,908	521,174	95%	97,768	18%	50,829	9%	372,577	68%	29,734	5%
Connecticut	332,067	306,125	92%	22,250	7%	41,453	12%	242,422	73%	25,942	8%
Delaware	74,779	66,216	89%	12,431	17%	7,482	10%	46,303	62%	8,563	11%
D.C.	55,250	48,885	88%	4,742	9%	5,448	10%	38,695	70%	6,365	12%
Florida	2,033,813	1,908,072	94%	485,302	24%	89,086	4%	1,333,684	66%	125,741	6%
Georgia	911,872	858,732	94%	138,895	15%	49,807	5%	670,030	73%	53,140	6%
Hawaii	121,491	108,326	89%	10,519	9%	7,216	6%	90,591	75%	13,165	11%
Idaho	153,147	146,202	95%	23,098	15%	14,314	9%	108,790	71%	6,945	5%
Illinois	1,132,893	1,042,081	92%	184,228	16%	59,679	5%	798,174	70%	90,812	8%
Indiana	487,113	465,613	96%	80,355	16%	31,376	6%	353,882	73%	21,500	4%
Iowa	261,766	244,290	93%	30,528	12%	18,053	7%	195,709	75%	17,476	7%
Kansas	239,820	222,447	93%	27,098	11%	16,332	7%	179,017	75%	17,373	7%
Kentucky	344,699	327,077	95%	43,851	13%	24,376	7%	258,850	75%	17,622	5%
Louisiana	379,400	351,869	93%	40,963	11%	30,425	8%	280,481	74%	27,531	7%
Maine	151,316	143,033	95%	20,385	13%	7,521	5%	115,127	76%	8,283	5%
Maryland	533,292	493,682	93%	66,302	12%	38,454	7%	388,926	73%	39,610	7%
Massachusetts	600,095	553,815	92%	74,619	12%	19,450	3%	459,746	77%	46,280	8%
Michigan	823,549	754,126	92%	105,485	13%	41,278	5%	607,363	74%	69,423	8%
Minnesota	499,946	473,247	95%	81,408	16%	30,341	6%	361,498	72%	26,699	5%
Mississippi	229,620	216,176	94%	22,044	10%	13,758	6%	180,374	79%	13,444	6%
Missouri	507,780	473,681	93%	55,815	11%	37,720	7%	380,146	75%	34,099	7%
Montana	114,440	108,437	95%	19,276	17%	9,236	8%	79,925	70%	6,003	5%
Nebraska	160,863	150,588	94%	23,478	15%	10,671	7%	116,439	72%	10,275	6%
Nevada	224,452	203,283	91%	36,441	16%	22,623	10%	144,219	64%	21,169	9%
New Hampshire	139,238	127,795	92%	10,736	8%	10,573	8%	106,486	76%	11,443	8%
New Jersey	788,534	713,530	90%	104,756	13%	80,317	10%	528,457	67%	75,004	10%
New Mexico	158,807	149,015	94%	17,763	11%	11,382	7%	119,870	75%	9,792	6%
New York	1,965,332	1,770,423	90%	288,437	15%	131,268	7%	1,350,718	69%	194,909	10%
North Carolina	810,411	761,251	94%	109,818	14%	54,779	7%	596,654	74%	49,160	6%
North Dakota	61,865	57,801	93%	8,014	13%	4,389	7%	45,398	73%	4,064	7%
Ohio	906,561	843,782	93%	99,285	11%	65,759	7%	678,738	75%	62,779	7%
Oklahoma	337,832	317,873	94%	41,088	12%	23,178	7%	253,607	75%	19,959	6%
Oregon	349,786	327,265	94%	48,491	14%	28,273	8%	250,501	72%	22,521	6%
Pennsylvania	990,101	933,831	94%	126,187	13%	68,986	7%	738,658	75%	56,270	6%
Rhode Island	97,124	90,013	93%	16,885	17%	5,897	6%	67,231	69%	7,111	7%
South Carolina	365,589	343,036	94%	48,671	13%	26,508	7%	267,857	73%	22,553	6%
South Dakota	77,581	73,607	95%	10,835	14%	5,370	7%	57,402	74%	3,974	5%
Tennessee	554,813	522,816	94%	27,952	5%	41,363	7%	453,501	82%	31,997	6%
Texas	2,191,724	2,051,593	94%	167,260	8%	141,075	6%	1,743,258	80%	140,131	6%
Utah	248,364	235,186	95%	45,568	18%	30,634	12%	158,984	64%	13,178	5%
Vermont	79,011	74,361	94%	10,411	13%	4,095	5%	59,855	76%	4,650	6%
Virginia	647,710	599,927	93%	91,260	14%	46,347	7%	462,320	71%	47,783	7%
Washington	556,559	521,387	94%	79,652	14%	44,739	8%	396,996	71%	35,172	6%
West Virginia	121,546	111,812	92%	10,238	8%	9,751	8%	91,823	76%	9,734	8%
Wisconsin	435,302	400,993	92%	50,211	12%	33,014	8%	317,768	73%	34,309	8%
Wyoming	60,681	56,812	94%	9,868	16%	6,006	10%	40,938	67%	3,869	6%
United States	27,342,488	25,523,840	93%	3,545,329	13%	1,817,547	7%	20,160,964	74%	1,818,648	7%

Source: U.S. Bureau of the Census, Statistics of U.S. Businesses and Non-employer Statistics.

Table B.3: Distribution of establishments by legal form of organization by state, 2007

State	All business	Flow-through business		S corporations		Partnerships		Sole proprietorships		C corporations	
	Number	Number	%	Number	%	Number	%	Number	%	Number	%
Alabama	409,693	372,336	91%	44,961	11%	29,228	7%	298,147	73%	37,357	9%
Alaska	71,688	66,246	92%	7,669	11%	4,657	6%	53,920	75%	5,442	8%
Arizona	524,903	473,395	90%	72,380	14%	51,426	10%	349,589	67%	51,508	10%
Arkansas	256,719	233,721	91%	34,283	13%	16,003	6%	183,435	71%	22,998	9%
California	3,600,225	3,238,096	90%	336,805	9%	204,503	6%	2,696,788	75%	362,129	10%
Colorado	574,539	527,758	92%	101,074	18%	53,426	9%	373,258	65%	46,781	8%
Connecticut	346,340	309,473	89%	23,824	7%	42,795	12%	242,854	70%	36,867	11%
Delaware	79,010	67,163	85%	12,920	16%	7,852	10%	46,391	59%	11,847	15%
D.C.	58,623	49,565	85%	5,096	9%	5,696	10%	38,773	66%	9,058	15%
Florida	2,118,031	1,929,346	91%	497,315	23%	95,497	5%	1,336,534	63%	188,685	9%
Georgia	955,909	869,567	91%	145,234	15%	53,387	6%	670,946	70%	86,342	9%
Hawaii	127,141	109,769	86%	11,359	9%	7,695	6%	90,715	71%	17,372	14%
Idaho	159,031	148,255	93%	24,360	15%	14,946	9%	108,949	69%	10,776	7%
Illinois	1,187,450	1,056,107	89%	192,230	16%	64,453	5%	799,424	67%	131,343	11%
Indiana	518,230	477,175	92%	86,899	17%	35,738	7%	354,538	68%	41,055	8%
Iowa	276,057	248,829	90%	33,444	12%	19,355	7%	196,030	71%	27,228	10%
Kansas	252,671	225,851	89%	29,205	12%	17,402	7%	179,244	71%	26,820	11%
Kentucky	362,998	332,926	92%	47,100	13%	26,629	7%	259,197	71%	30,072	8%
Louisiana	398,941	356,934	89%	43,787	11%	32,358	8%	280,789	70%	42,007	11%
Maine	156,407	144,570	92%	21,479	14%	7,867	5%	115,224	74%	11,837	8%
Maryland	556,289	499,436	90%	69,364	12%	40,354	7%	389,718	70%	56,853	10%
Massachusetts	626,825	560,102	89%	78,491	13%	21,243	3%	460,368	73%	66,723	11%
Michigan	864,859	765,222	88%	111,840	13%	45,146	5%	608,236	70%	99,637	12%
Minnesota	523,358	480,991	92%	86,479	17%	32,272	6%	362,240	69%	42,367	8%
Mississippi	241,628	219,315	91%	23,994	10%	14,805	6%	180,516	75%	22,313	9%
Missouri	535,758	481,440	90%	60,681	11%	40,120	7%	380,639	71%	54,318	10%
Montana	118,364	109,920	93%	20,229	17%	9,634	8%	80,057	68%	8,444	7%
Nebraska	168,990	153,047	91%	25,091	15%	11,346	7%	116,610	69%	15,943	9%
Nevada	235,111	206,513	88%	38,119	16%	23,753	10%	144,641	62%	28,598	12%
New Hampshire	144,711	129,128	89%	11,526	8%	10,989	8%	106,613	74%	15,583	11%
New Jersey	820,067	720,749	88%	108,514	13%	82,890	10%	529,345	65%	99,318	12%
New Mexico	166,400	151,211	91%	18,980	11%	12,108	7%	120,123	72%	15,189	9%
New York	2,026,063	1,785,277	88%	296,086	15%	137,099	7%	1,352,092	67%	240,786	12%
North Carolina	854,215	773,856	91%	118,127	14%	58,266	7%	597,463	70%	80,359	9%
North Dakota	64,716	58,693	91%	8,628	13%	4,574	7%	45,491	70%	6,023	9%
Ohio	965,137	860,059	89%	108,707	11%	70,949	7%	680,403	70%	105,078	11%
Oklahoma	353,614	322,739	91%	43,708	12%	24,994	7%	254,037	72%	30,875	9%
Oregon	366,125	332,728	91%	51,669	14%	30,017	8%	251,042	69%	33,397	9%
Pennsylvania	1,044,926	948,584	91%	134,460	13%	73,835	7%	740,289	71%	96,342	9%
Rhode Island	100,318	90,924	91%	17,518	17%	6,136	6%	67,270	67%	9,394	9%
South Carolina	386,631	348,568	90%	52,234	14%	28,134	7%	268,200	69%	38,063	10%
South Dakota	80,653	74,810	93%	11,647	14%	5,625	7%	57,538	71%	5,843	7%
Tennessee	585,075	530,494	91%	31,348	5%	44,940	8%	454,206	78%	54,581	9%
Texas	2,307,398	2,086,358	90%	181,201	8%	158,785	7%	1,746,372	76%	221,040	10%
Utah	258,092	238,103	92%	47,150	18%	31,681	12%	159,272	62%	19,989	8%
Vermont	81,349	75,166	92%	10,954	13%	4,290	5%	59,922	74%	6,183	8%
Virginia	687,191	610,200	89%	97,499	14%	49,675	7%	463,026	67%	76,991	11%
Washington	584,177	529,779	91%	84,488	14%	47,441	8%	397,850	68%	54,398	9%
West Virginia	129,079	113,919	88%	11,325	9%	10,604	8%	91,990	71%	15,160	12%
Wisconsin	459,745	409,157	89%	55,703	12%	35,154	8%	318,300	69%	50,588	11%
Wyoming	63,014	57,569	91%	10,319	16%	6,259	10%	40,991	65%	5,445	9%
United States	28,834,484	25,949,366	90%	3,785,730	13%	1,964,031	7%	20,199,605	70%	2,885,118	10%

Source: U.S. Bureau of the Census, Statistics of U.S. Businesses and Non-employer Statistics.

Table B.4: Distribution of receipts (\$ millions) by legal form of organization by state, 2007

State	All business	Flow-through business		S corporations		Partnerships		Sole proprietorships		C corporations	
	Number	Number	%	Number	%	Number	%	Number	%	Number	%
Alabama	384,892	135,461	35%	78,988	21%	38,824	10%	17,649	5%	249,431	65%
Alaska	72,940	21,724	30%	12,484	17%	4,955	7%	4,285	6%	51,215	70%
Arizona	478,060	176,680	37%	95,605	20%	54,695	11%	26,380	6%	301,380	63%
Arkansas	227,684	74,916	33%	45,230	20%	19,850	9%	9,836	4%	152,768	67%
California	3,536,595	1,211,614	34%	655,872	19%	309,608	9%	246,134	7%	2,324,981	66%
Colorado	472,174	173,353	37%	100,811	21%	51,040	11%	21,502	5%	298,821	63%
Connecticut	509,444	153,176	30%	79,968	16%	50,562	10%	22,647	4%	356,268	70%
Delaware	163,835	43,478	27%	14,543	9%	26,112	16%	2,823	2%	120,358	73%
D.C.	108,809	31,399	29%	8,583	8%	19,636	18%	3,180	3%	77,410	71%
Florida	1,435,153	585,445	41%	396,746	28%	123,359	9%	65,340	5%	849,708	59%
Georgia	898,898	293,938	33%	176,184	20%	82,489	9%	35,266	4%	604,959	67%
Hawaii	93,154	28,605	31%	13,190	14%	9,463	10%	5,952	6%	64,549	69%
Idaho	101,317	49,951	49%	30,076	30%	13,843	14%	6,032	6%	51,366	51%
Illinois	1,406,004	488,319	35%	279,560	20%	157,457	11%	51,302	4%	917,685	65%
Indiana	597,163	232,583	39%	134,804	23%	71,552	12%	26,228	4%	364,579	61%
Iowa	298,505	94,711	32%	59,544	20%	21,377	7%	13,790	5%	203,793	68%
Kansas	283,279	90,615	32%	48,112	17%	26,805	9%	15,699	6%	192,663	68%
Kentucky	383,110	138,562	36%	66,630	17%	55,240	14%	16,691	4%	244,548	64%
Louisiana	517,075	184,542	36%	74,174	14%	91,590	18%	18,777	4%	332,533	64%
Maine	88,177	37,302	42%	24,443	28%	6,408	7%	6,451	7%	50,875	58%
Maryland	464,997	168,094	36%	102,395	22%	41,982	9%	23,717	5%	296,903	64%
Massachusetts	700,428	238,152	34%	141,098	20%	59,225	8%	37,829	5%	462,277	66%
Michigan	858,029	269,778	31%	151,057	18%	83,663	10%	35,057	4%	588,252	69%
Minnesota	561,669	204,868	36%	132,497	24%	43,620	8%	28,750	5%	356,802	64%
Mississippi	191,039	68,342	36%	35,519	19%	19,821	10%	13,001	7%	122,698	64%
Missouri	522,637	177,100	34%	109,866	21%	43,867	8%	23,367	4%	345,537	66%
Montana	64,898	31,087	48%	19,387	30%	6,960	11%	4,740	7%	33,811	52%
Nebraska	174,027	56,804	33%	38,898	22%	11,493	7%	6,413	4%	117,223	67%
Nevada	222,582	94,459	42%	51,415	23%	29,432	13%	13,612	6%	128,122	58%
New Hampshire	108,528	42,489	39%	24,013	22%	10,577	10%	7,899	7%	66,039	61%
New Jersey	1,069,512	359,999	34%	202,345	19%	104,311	10%	53,343	5%	709,513	66%
New Mexico	123,639	45,920	37%	24,293	20%	14,140	11%	7,487	6%	77,719	63%
New York	2,088,545	773,576	37%	402,886	19%	276,403	13%	94,288	5%	1,314,969	63%
North Carolina	796,653	264,122	33%	157,364	20%	63,590	8%	43,167	5%	532,532	67%
North Dakota	56,091	20,483	37%	14,543	26%	3,157	6%	2,783	5%	35,609	63%
Ohio	1,069,317	347,352	32%	196,748	18%	102,544	10%	48,061	4%	721,965	68%
Oklahoma	307,319	117,746	38%	70,116	23%	30,556	10%	17,074	6%	189,573	62%
Oregon	305,449	119,147	39%	70,706	23%	30,848	10%	17,592	6%	186,302	61%
Pennsylvania	1,094,942	408,343	37%	240,821	22%	96,589	9%	70,933	6%	686,599	63%
Rhode Island	77,387	33,534	43%	23,995	31%	5,659	7%	3,880	5%	43,852	57%
South Carolina	324,329	114,093	35%	64,965	20%	30,347	9%	18,781	6%	210,236	65%
South Dakota	75,523	29,143	39%	19,549	26%	5,466	7%	4,127	5%	46,380	61%
Tennessee	533,474	179,818	34%	69,705	13%	77,230	14%	32,883	6%	353,656	66%
Texas	2,571,836	936,397	36%	311,198	12%	479,065	19%	146,134	6%	1,635,439	64%
Utah	222,436	88,737	40%	53,693	24%	26,627	12%	8,418	4%	133,699	60%
Vermont	42,579	18,753	44%	12,498	29%	2,888	7%	3,367	8%	23,827	56%
Virginia	710,350	217,330	31%	132,474	19%	53,931	8%	30,925	4%	493,020	69%
Washington	591,290	221,767	38%	126,491	21%	63,791	11%	31,485	5%	369,523	62%
West Virginia	108,480	36,387	34%	17,898	16%	11,203	10%	7,285	7%	72,093	66%
Wisconsin	520,945	194,293	37%	131,361	25%	38,298	7%	24,635	5%	326,652	63%
Wyoming	64,942	27,013	42%	15,706	24%	8,734	13%	2,573	4%	37,929	58%
United States	28,680,137	10,148,255	35%	5,557,806	19%	3,110,877	11%	1,479,572	5%	18,531,882	65%

Source: U.S. Bureau of the Census, Statistics of U.S. Businesses and Non-employer Statistics.

¹ Sole proprietorships, which are not flow-through entities per se, report their income and deductions on Form 1040, Schedule C, and are subject to the individual income tax on such income.

² The statistic was calculated over the five year period due to significant year-to-year fluctuations in business income among both C corporations and flow-through businesses as the economy weakened in 2007 and 2008. Excluding 2008 from this average lowers the share of flow-through income to 52 percent.

³ President Obama's State of the Union address, January 25, 2011.

⁴ In 2013, the top individual tax rate is scheduled to rise from 35 percent to 39.6 percent and the Medicare tax rate is scheduled to rise from 2.9 percent to 3.8 percent.

⁵ According to the Organisation for Economic Co-operation and Development, the United States has one of the largest non-corporate sectors. See Organisation for Economic Co-operation and Development, "Survey on the Taxation of Small and Medium-Sized Enterprises," September 25, 2007.

⁶ The data presented here (Chart 1) also include RICs and REITs, which effectively are subject to a single layer of tax because of the deductibility of dividends. Note that RICs and REITs are included among C corporations in the Census data on employment, firms and establishments presented below due to data limitations.

⁷ As discussed below, it is important to note that the line between activity ultimately subject to the corporate tax or individual tax is blurred because some flow-through businesses, primarily partnerships and limited liability companies, can have corporate owners. Also note that the 82 percent of net income reported by all flow-through entities is for 2008, whereas the 54 percent of net income reported by individual owners of flow-through entities is the average from 2004 through 2008.

⁸ Limited partnerships, which offer limited liability to the limited partners, along with flow-through treatment, were available.

⁹ In 1988 the IRS issued a revenue ruling indicating that it would treat LLCs established under Wyoming state law as partnerships for tax purposes. Other states subsequently enacted similar LLCs statutes.

¹⁰ In 1995, there were 118,559 LLCs in the United States. By 2008 the number had grown to 1,898,178. Internal Revenue Service, *Partnership Returns, 2008*, Statistics of Income Bulletin, Fall 2010.

¹¹ These tabulations exclude the non-profit and government sectors. RICs/REITs are included among C corporations due to data limitations. U.S. Bureau of the Census, Center for Economic Studies, 2008.

¹² Sole proprietors are counted as one "employee." A summary of the data and methodology used for these tabulations is provided in Appendix A.

¹³ Sole proprietorships are, by definition, owned by individuals and the ownership of S corporations is generally restricted to individual shareholders.

¹⁴ In 2007, about 30 percent of partnership income was allocated to corporate partners. Wheeler and Nina Shumofsky, *Partnership Returns, 2008*, Statistics of Income Bulletin, Fall 2010.

¹⁵ The net income and taxes paid by individual owners of flow-through businesses and C corporations are not directly comparable because the labor compensation of owners of C corporations are generally paid as wages and deductible to the business, while the labor compensation paid to owners of partnerships and sole proprietorships is generally included as part of business entities' allocable net income. S corporations, in contrast, are generally required to pay owners actively involved in a business a reasonable level of compensation, which, similar to C corporations, is a deductible expense by the business. Taking into account the amount of labor compensation paid to owners of partnerships and sole proprietorships as allocable net income could have a significant effect on these calculations.

¹⁶ This comparison only takes into account the taxes related to the net income of flow-through businesses and C corporations. Investor level taxes on corporate earnings are not taken into account.

¹⁷ Donald Bruce and Tami Gurley-Calvez, "Federal Tax Policy and Small Business," In *Overcoming Barriers to Entrepreneurship*, Rowan and Littlefield Publishers, forthcoming; William M. Gentry and R. Glenn Hubbard, "Success Taxes, Entrepreneurial Entry, and Innovation," Working Paper No. 10551, National Bureau of Economic Research, June 2004.

¹⁸ Robert Carroll, Douglas Holtz-Eakin, Mark Rider and Harvey Rosen, "Income Taxes and Entrepreneurs' Use of Labor," *Journal of Labor Economics*, April 2000, 18(2), pp. 324-351; Robert Carroll, Douglas Holtz-Eakin, Mark Rider and Harvey Rosen, "Personal Income Taxes and the Growth of Small Firms," *Tax Policy and the Economy*, NBER, Vol. 15, 2001, pp. 121-147; and Robert Carroll, Douglas Holtz-Eakin, Mark Rider and Harvey Rosen, "Entrepreneurs, Income Taxes, and Investment," In *Does Atlas Shrug? The Economic Consequences of Taxing the Rich*, Joel Slemrod, ed., Russell Sage Foundation and Harvard University Press, NY, 2002, pp. 427-455.

¹⁹ Robert Carroll, Douglas Holtz-Eakin, Mark Rider and Harvey Rosen, "Entrepreneurs, Income Taxes, and Investment," In *Does Atlas Shrug? The Economic Consequences of Taxing the Rich*, Joel Slemrod, ed., Russell Sage Foundation and Harvard University Press, NY, 2002, pp. 427-455.

²⁰ Robert Carroll, Douglas Holtz-Eakin, Mark Rider and Harvey Rosen, "Income Taxes and Entrepreneurs' Use of Labor," *Journal of Labor Economics*, April 2000, 18(2), pp. 324-351.

²¹ Robert Carroll, Douglas Holtz-Eakin, Mark Rider and Harvey Rosen, "Personal Income Taxes and the Growth of Small Firms," *Tax Policy and the Economy*, NBER, Vol. 15, 2001, pp. 121-147.

²² For a similar analysis that considers the effects of revenue neutral business tax rate reduction financed by repeal of all business tax expenditures see Gerald Prante, Robert Carroll, and Thomas Neubig, "Lowering Business Tax Rates by Repealing Tax Expenditures: An Industry Analysis," *Bureau of National Affairs Daily Tax Report*, Vol. 2011, No. 34, February 18, 2011.

²³ Includes only permanent, positive tax expenditures.

²⁴ Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014," (JCS-3-10), December 15, 2010.

²⁵ The procedure for estimating the income tax paid on flow-through business income estimated the income tax liability of owners of flow-through businesses with and without their flow-through business income. This approach, described in

greater detail in Appendix A: Data sources/simulations, assumes flow-through business income is a taxpayer's last dollar of income earned. The income and associated taxes for RICs/REITs are excluded for purposes of this calculation.

²⁶ This estimate includes the higher taxes on ordinary income reported by flow-through businesses, as well as taxes paid on other flow-through income reported on individual tax returns, such as capital gains, rental income, and royalty income.

²⁷ See, for example, Robert Carroll and David Joulfaian, "Do Taxes Affect Corporate Financial Decisions? -- The Choice of Organizational Form," U.S. Treasury Department, Office of Tax Analysis, Working Paper 73, October 1997; and Austan Goolsbee, "Taxes, Organizational Form, and the Deadweight Loss of the Corporate Income Tax," *Journal of Public Economics*, 69(1), 1998, pp. 143-152.

²⁸ For a discussion of these issues see Robert Carroll, "The Economic Effects of the Lower Tax Rate on Dividends," Tax Foundation Special Report No. 181, June 2010.

²⁹ For example, a dynamic analysis of the lower tax rates on dividends and capital gains enacted in 2003 found that they would increase gross domestic product in the long-run by 0.4 percent and the capital stock by 1.2 percent if made permanent. See U.S. Department of the Treasury, *A Dynamic Analysis of Permanent Extension of the President's Tax Relief*, July 25, 2006.

³⁰ See, for example, Louise Marshall, "New Evidence on Fiscal Illusion: The 1986 Tax "Windfalls," *American Economic Review*, Vol. 81(5), December 1991, pp. 1336-1344.