

The Economic Effects of Corporate Rate Reductions:

*Pass-through entities, non-corporate businesses,
and organizational form*

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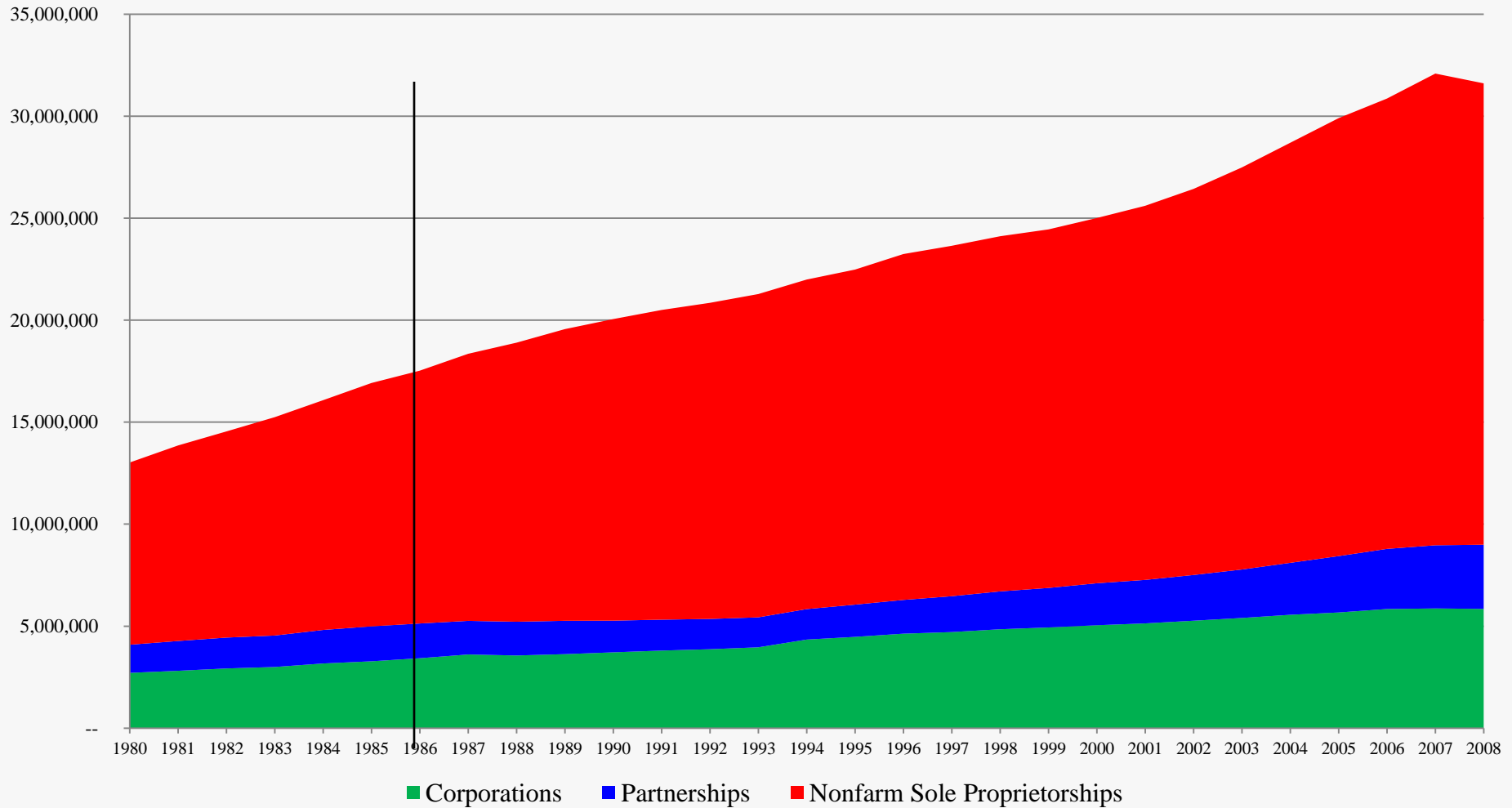
Corporate versus Business Tax Reform

- What are the key issues related to organizational form
- What are the potential concerns and remedies
- What can we learn from the Tax Reform Act of 1986

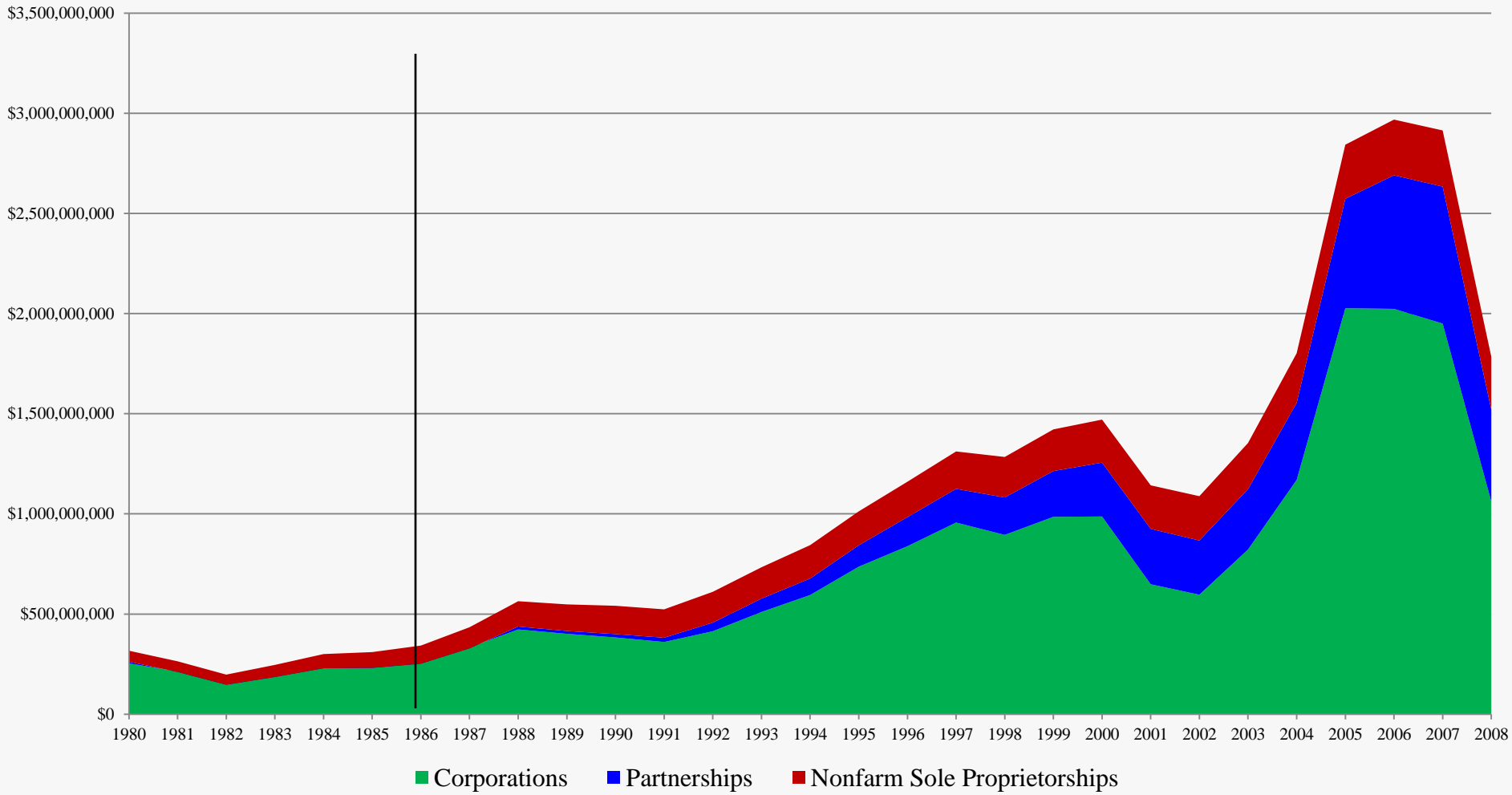
Organizational forms

- Sole-proprietorship
 - Income reported / taxed with the individual
- Partnership (Including LLPs and LLCs)
 - Separate legal entity, income/expenses flow to individual
 - No entity-level tax
- Corporation
 - Separate legal entity subject to an entity level tax (C corp)
 - Individual taxed on distributed earnings
 - “S corporations” taxed as a pass-through

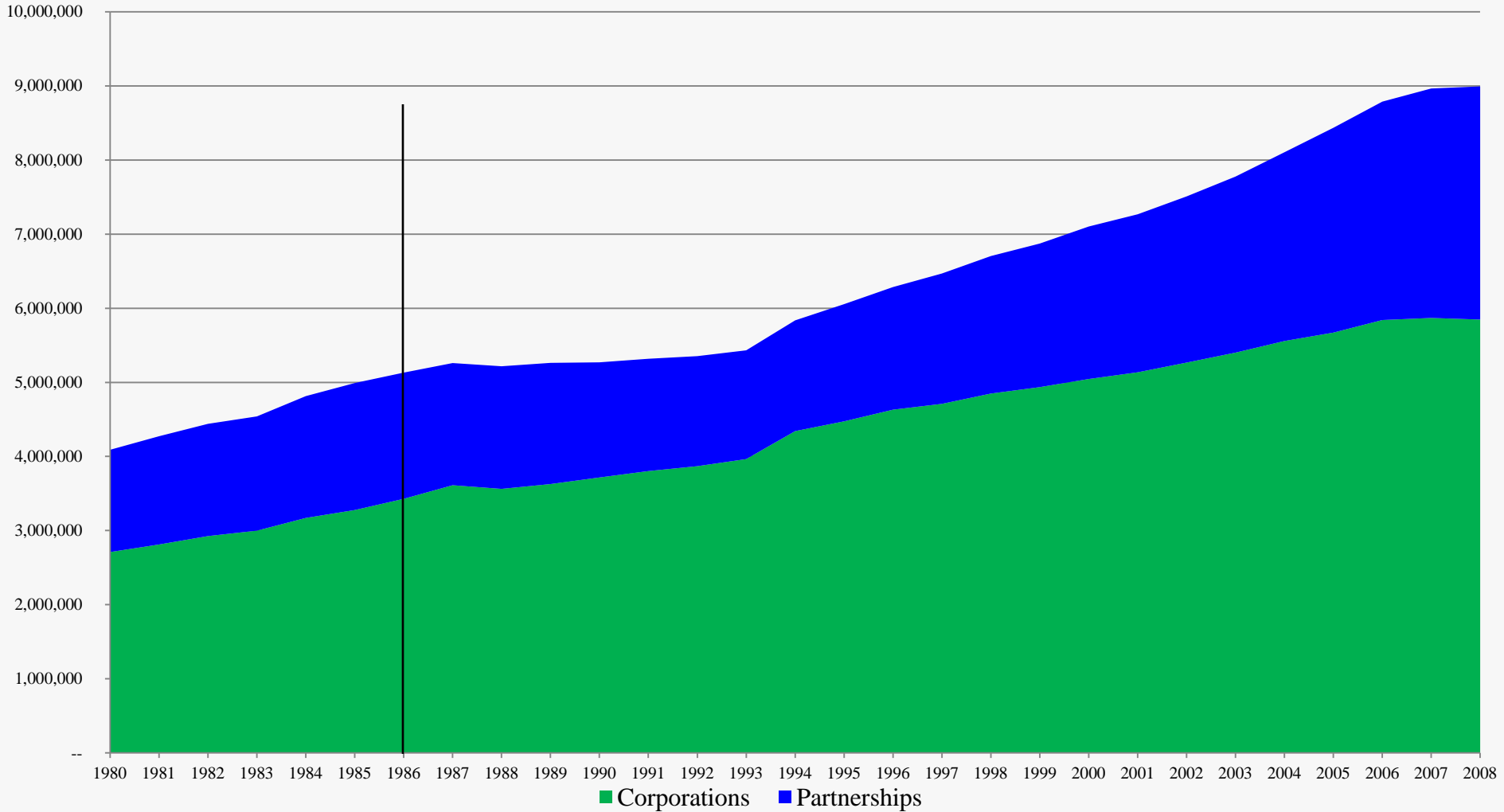
Business Returns by Type



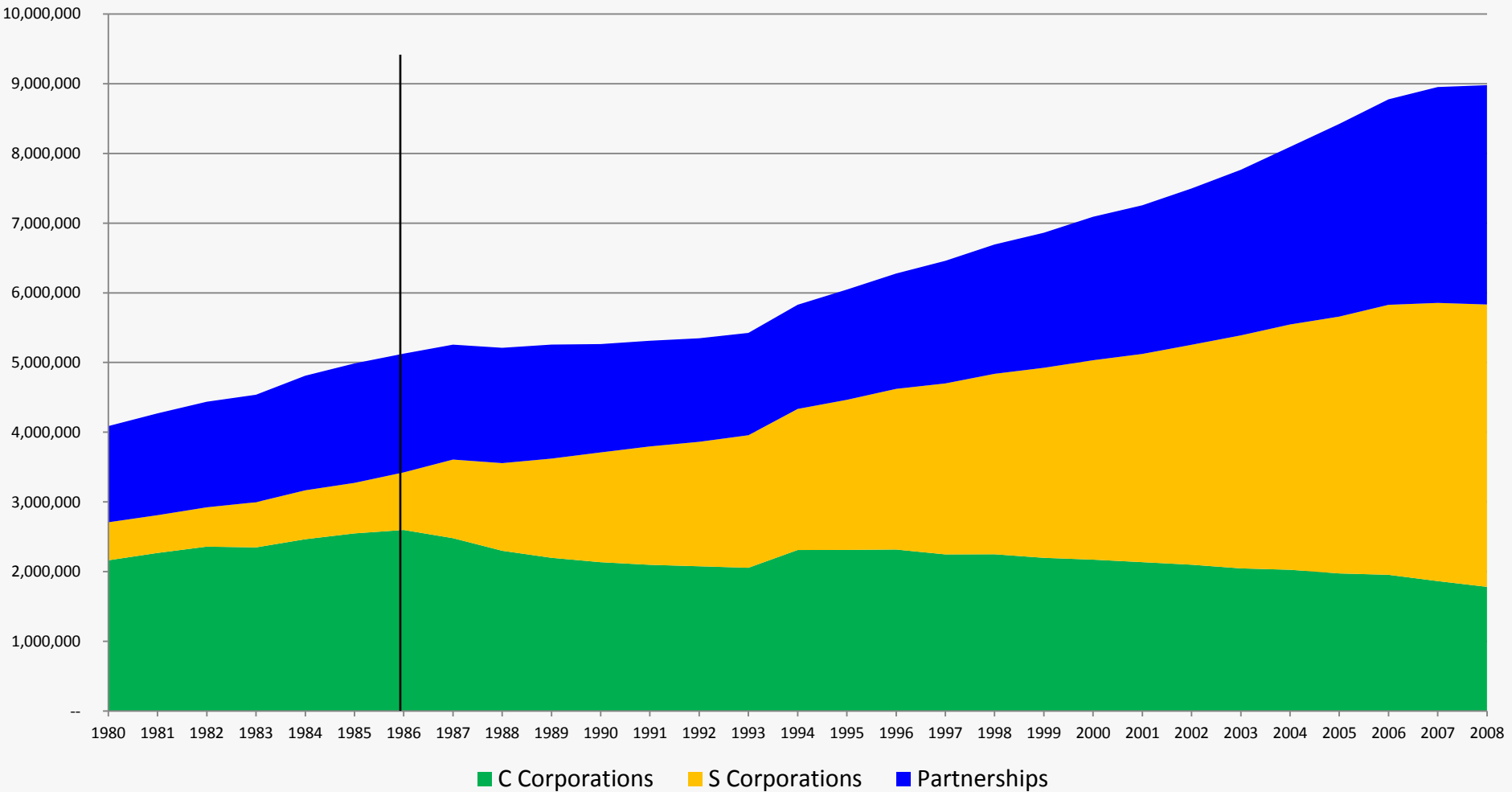
Business Activity: NILD by Type



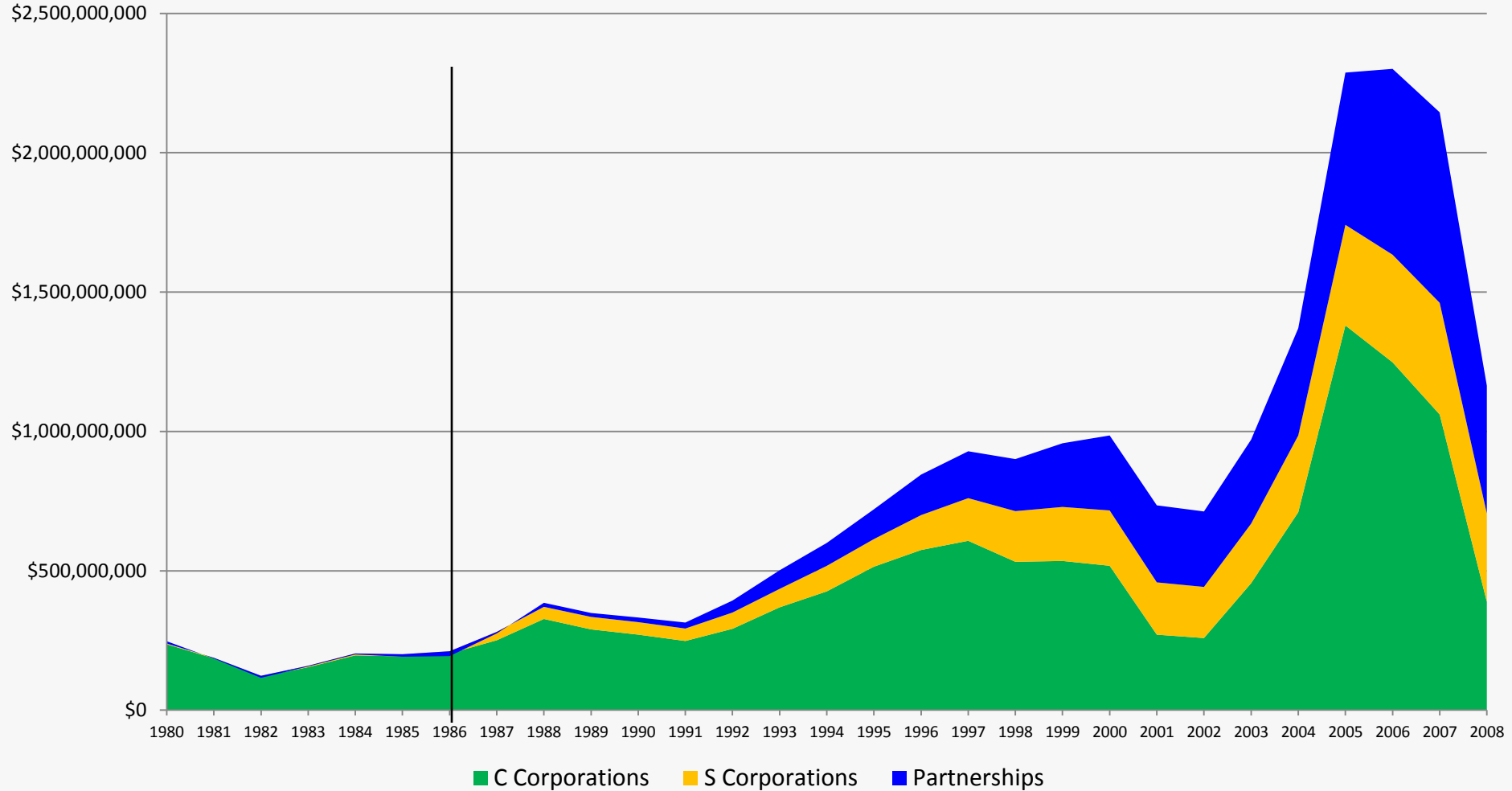
Returns by Type – Partnerships and Corporations



Returns by Type – Partnerships and Corporations



NILD by Type - Partnerships and Corporations



Why Does this Matter?

- Much of the current discussion on *corporate* taxes suggests broadening of the *business* tax base to offset the cost of lowering of the rate.
 - *NB*: JCT report suggests it is hard to get below 28%
- Without a change in the individual tax rate the base-broadening of business provisions will increase the tax burden on pass-through entities as they lose deductions without gaining the benefits of a rate reduction.
- A lower corporate rate, especially when coupled with a broader base influences the choice of organizational form.

Why Does this Matter?

- Creates incentives for planning.
 - Higher individual rates lead to the use of corporations as shelters.
 - After 1986, the corporate rate was reduced to 34% while the individual rate was reduced to 28%
 - Preferential capital gains rates increase the incentive.
- “Corporate” discussions need to consider broader individual changes and the rationalization of tax rates on *all* types of income: corporate, individual, ordinary, capital gain, and dividend