ISSUE BRIEF

NSBA National Small Business Association®

Corporate Tax Reform and Small Business

Tax reform must be all-inclusive and not disproportionally harm small businesses

Problem:

The overwhelming majority of small businesses—83 percent—are organized as pass-through entities, meaning they file taxes through the individual income tax code instead of the corporate income tax code. Unfortunately, some policymakers are promoting corporate tax reform despite the fact that it will not only not help most small businesses, it could result in an effective higher tax rate.

- Since pass-through businesses pass their income and losses directly to their owners, these businesses face the same marginal tax rates as individuals.
- Pass-through businesses account for more than half of the business income and employment in the U.S.
- Pass-through businesses are subject to both the federal individual income tax, with a top rate of 43.4 percent, and state and local income taxes, with rates ranging up to 13.3 percent.
- Although traditional C corporations pay a higher overall tax rate on their income, there are specific advantages to the C corporation—the ease of raising money, less restrictive shareholder rules (compared to an S corporation), and deferral of domestic taxation.
- Any increase to the individual tax rate taxes the capital small businesses rely on to purchase new equipment, pay salaries and benefits of workers, and meet day-to-day expenses.
- Allowing the smallest businesses to pay a much higher tax on their business income than a multinational, multi-billion dollar corporation undercuts any semblance of fairness.
- If the business tax base is broadened, i.e.: eliminating certain business credits and deductions, and corporate tax rates substantially lowered while individual tax rates are reduced only slightly or not at all, the result will be a larger tax increase on those pass-through small businesses – many of which rely on possibly eliminated business credits and deductions.

Solution:

One of the main goals of fundamental tax reform is to make U.S. businesses more competitive and to increase economic growth. This requires a reduction in taxes on businesses and investment. Most attention is given to traditional C corporations because they face high tax burdens by international standards and account for a large amount of economic activity. As a result, less attention has been given to pass-through businesses. Since pass-through businesses account for more than half of the business income and employment in the U.S., any business tax reform needs to address the individual income tax code as well as the corporate income tax code. NSBA opposes efforts to pass corporate-only tax reform without some kind of workable solution for the millions of pass-through small businesses which play an important role in the economy and have been a growing source of entrepreneurship.

- Any serious tax reform proposal must also include lowering the individual tax rate to support pass-through businesses.
- A corporate-only approach to tax reform will ensure that small business shoulders a much greater tax burden than mega-corporations—parity is a must.

Learn More:

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